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PRODUCTIVITY COMMISSION

INQUIRY INTO SUPERANNUATION

MR P HARRIS, Presiding Commissioner
MS K CHESTER, Commissioner

TRANSCRIPT OF PROCEEDINGS

AT 530 COLLINS STREET, MELBOURNE
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MR HARRIS: Good morning. Thanks, everybody, for attending the hearings here and to the second phase of our three-phase superannuation inquiry. I'm Peter Harris, the Chairman of the Productivity Commission. With me is Karen Chester who's our Deputy Chair. Before we start up all the phase of the hearings things, I don't know whether no one else has gone through it. I don't think they probably have. I have to tell you the evacuation procedures, which basically are pretty straightforward.

See exit sign. Follow instructions of people wearing red hats, and we'll be walking down the stairs if there is a need for evacuation; straight out there and down there. I should also tell people that we try and avoid, because we are recording this and, in the end, we'll publish the nature of the transcript, we try and avoid making defamatory remarks. If, indeed, we feel you are likely to lurch into defaming any particular individual, we will ask you to cease. That has actually happened once or twice in my time doing this job. People do get a little bit passionate. Perhaps we can just encourage everybody to be the least passionate they can be. We tend to be only doing inquiries in areas where people do get passionate, so it's a pretty normal sort of thing.

We do allow people to utilise social media from the room. There's no restrictions of the nature of that kind of thing. But we don't take questions from the floor. The purpose of this hearing is to hear from the individuals who've registered for the hearings. But at the end, if those of you who wish to wait patiently around, if there is anybody here who hasn't registered and would like to make a comment or ask a question, we're happy to take those right at the tail end of the hearings.

Thank you very much then. I think we'll start out. Can you please, for the record, identify yourself?

MR DALEY: I'm Brian Daley, I'm the Capital Stewardship Officer at the Australian Council of Trade Unions.

MR HARRIS: Brian, do you want to make a few limited comments at the outset? We've got submissions, but I know there hasn't been a lot of time for everybody to read them.

MR DALEY: I do. Thank you, Chair. I do have a very brief submission basically pointing to the issues that the ACTU particularly wanted to, I guess, make in a public sense as well too. It's a short one page. I'm happy to give the Commission a copy of what I intend to say in that.

MR HARRIS: We're recording it all anyway, so we'll be okay with that.

MR DALEY: Even in respect of the comments, they're very brief. I'm sort of slightly – sort of expand on what's in here anyway. Essentially, the ACTU has made substantial comment in submission in relation to the issue of superannuation and fund choice being treated as an industrial issue. Suffice to say for the purpose of these hearings, we note that two of the alternate models proposed by the Commission, being assisted employee choice and assisted employer choice, are both models which have an industrial relations character in that they involve one of the participants in the workforce – that's the employer – being engaged in a decision in relation to an industrial matter.

We assert our view that this, thus, requires the framework which is to be implemented, if those models are selected, to have a proper industrial relations character and should have workers and their representatives involved in that decision. On other substantive issues we make the following comments. Firstly, we urge the Commission to think about the basis for comparison not being its defined model of unassisted employee choice. In our view, this will not deal with the relevant issue for Australian workers looking to the review and subsequent legislation, that issue being, how will the Commission's recommendations affect my current situation?

We say that the models out there don't attempt to basically make any statement as to whether or not the models that people are in at the moment will be or will not be affected by the introduction of any alternate models. Our general view of that is this: is that if you're in a model which becomes one of the selected default funds, then you would probably argue the case that there is no impact on the person. Say the Commission selects – the processes lead to a situation where 10 funds are selected and they cover essentially half the workforce at the moment and that half the workforce are in default funds and those people will probably be unaffected. But half the workforce will have an impact if the fund that they're in is not selected as a default fund.

Again, our almost back of the envelope calculations in this we'd say something like that if you're in a typical call it a retail fund where the asset allocation is likely to be completely unaffected by whether it's a default fund or not, then that perhaps 20 per cent of the remaining 50 would be unaffected. But potentially for the remaining 80 per cent of the 50, that is, 40 per cent of the population, there is a real risk in this process that their default situation or their superannuation situation will be worsened by the implementation of the report models.

MR HARRIS: Can I just clarify though with you, you're creating a sort of static division of today's funds and saying, "If there's only four or five, then even if they're the biggest four or five, they only cover half of the workforce."

MR DALEY: That's a broad assumption, yes.

MR HARRIS: Therefore, there's this other half that aren't definitionally either currently members of those winning four or five and therefore they're not necessarily going to make any active choice as a consequence of this and move to those four or five, they're going to remain passive and stick where they are and therefore they're not, as it were, winners from the system; that's basically what you're saying?

MR DALEY: Broadly. We'd say this: that one of the implications of the review is that if you're in a fund that is not a winner and whose performance is likely to be affected by the fact that they lose access to default people, one of the pieces of advice to that fund may well be merge or get out or, essentially, if you're a member of the fund you may be better off thinking about getting out of that fund and into one of the other default funds.

Over time there will clearly be, if you like, a level of advice and rationalisation of what happens to the sector. What we do say is that people will look at, if you like, the utility of this review and say, "At the time that change happens or default funds come in, am I better or am I worse by the system?" If you're in a fund that's not selected, that has to change its asset allocation because of the fact that it hasn't got the flow of default members, you are likely to be in a situation where your fund is worse off than before the change happened.

MS CHESTER: Brian, we were very mindful in how we developed the models and some of the key elements to all four models about your issue of system stability, like how this would transition over time. By limiting the models to just the new job entrant it's not all the default turnover market. Indeed, it's 400,000 and there's 400,000 new job entrants each year, which is worth a couple billion. Then you've got over 1 million that are the rest of the default market, people changing jobs every year. Again, the default is only kind of like 40 per cent of the total super system contribution. And we're only doing it once every four years.

So we've been very mindful to make sure that if there's any underperforming fund that continually doesn't get through on any of our models they would still have their existing default members, they still can go and play in the choice market. So it would be a very gradual transition, very mindful of the impact on those members that would still remain in those funds.

MR DALEY: I'd say this about it is that there are a range of people who stay, because of the nature of their employment at the moment or the fact that a fund is a common fund at their place of employment – may not be a default fund but they may want to stay with that fund for a period of time. Now, if many of those funds are pushed into situations where they lose access to a large number of default members, then the nature of the way in which they do their investments will change. They will have a situation where they may well be in negative cash flow in a very short period of time because they're not getting the new members and new cash flow into the fund that they would normally expect. If they are in that position, then the trustees of those funds would have to essentially take a decision to look at the asset allocation of those funds to decide whether or not they could continue to invest in liquid assets, whether they had to have a greater weighting to cash assets and the like. We say that is likely in those cases those funds will perform worse than they did before they had the default flow, before the (indistinct) flow.

MS CHESTER: But that's in the current super system we already have that. We've got 80 of the APRA regulated funds already in net outflow territory.

MR DALEY: There's a very skew curve about who's in negative territory at the moment. Yes, there may be 80 or several hundred funds are in there. It may well be that after this system comes in there may be 10 funds in positive cash flow territory and everybody else in negative cash flow territory.

MS CHESTER: Maybe if we kind of bring it back to maybe just a really simple fundamental question. And very happy just for a yes/no answer, Brian. Do you think in the default segment of the super system that poor-performing funds, so funds that continue to poorly perform over time, should exit and that new entrants, high-performing new entrants, should be able to provide default super products? I'm happy for a yes/no and then you can elaborate on it.

MR DALEY: The answer is yes, we believe there should be a test on performance. If you went – our submission into the first stage of stage 2 where we proposed a model that looked at how the expert panel might be guided to choose funds, we said performance was an issue.

MS CHESTER: We agree on performance. But, I guess, going back to my question, do you think poor-performing funds over time should exit and we should allow new entrants that are high performing to enter the default segment?

MR DALEY: It's a bit of a question of whether or not this model will actually lead to an opportunity for new entrants to enter the marketplace.

MS CHESTER: I guess my question is totally separate to the models. Just in principle, do you think that should be able to happen?

MR DALEY: It's not the way in which the superannuation will operate. It's a bit like other financial services. You don't say because one bank is underperforming at the moment that we expect that someone is going to invent a new bank out there and there's going to be a fifth pillar in the banking system. That just doesn't happen. The same thing will happen in superannuation. Once there is a strong default basis in there, there won't be an advent of new entrants to the market saying, "Look, we can offer these services. We've got a track record. We can get scale." That just won't happen. There'll be inertia around – a form of oligopoly of the major funds.

But we do say this, and we've said this all along, that there should be a test about poor-performing funds and if poor-performing funds are not performing, then their right to basically hold their position in any default arrangement should be under question.

MR HARRIS: It's hard to see this working in practice now because we do have just about everybody – I mean, I think you've just made a sort of lean, at least, towards answering Karen's question in the affirmative, and so does just about everybody. But very few people can come up with how that catalytic effect should occur. Right now it seems to be mentally attributed in most of the submissions we've received and the sort of general comments we get to, "Well, APRA should do something more." But no one's really prepared to be too explicit about how far APRA otherwise should go. You can understand the position of a regulator who perhaps – I don't want to put words in their mouth – but really doesn't want to go and put the heavy hand on the shoulder and say to somebody, "Gee, your time is up, number 7, come in."

We're very interested in this because of the member impact. It's probably time, now we're five minutes into this, one of the things I found remarkable in this process has been the limited number of times that members are mentioned individually versus funds. Funds come up right at the start. Everybody wants to speak on behalf of a fund. There is a view about members, but it sort of comes next. We're interested in the APRA side of things because somebody should be up there querying on behalf of those members, don't you think? Somebody should be saying, as it were, "Come in, number 7, your time is up," but nobody seems to be able to come up with a proposition by which that should occur.

Now, I'm not saying we won't. I'm actually alluding to the value of the question being we probably will. But we're really interested in getting advice on it first.

MR DALEY: We have urged that to be a proper position is the first point of our comparison is that there should be some – our statement today is that there should be some rigorous approach to seeing whether members are going to be better off or not better off under the system. And the unassisted employee choice model doesn't do that.

MR HARRIS: I think we've had this discussion previously. It's not really a model, it's the zero benchmark by which we decided that the most objective way of coming up with a set of criteria which said, "Now, how do each of the active actual models," 1, 2, 3, 4 in our proposition, "how do they look versus zero?" and it answers the question why have a default system. So we accept your proposition that it's a dreadful model. We counter-argue it was never a model, and I think we should move on from that, acknowledging that both positions can be held together and still look at this APRA-based question. I'm very interested in this APRA-based question.

MR DALEY: We said that there is a model that you should be comparing from and that's the current default models, but you've chosen not to do that.

MR HARRIS: We're in phase 2, as we pointed out. In phase 3 I'm sure the whole question of the industrial relations system will come up definitionally. We'll be happy to get to it then, but right now I'm interested in this question of what happens with poorly-performing funds. By the bye, just in case anybody who's otherwise taking notes from this thinks otherwise, poorly-performing funds include all kinds of funds.

MR DALEY: Our response to that is that the current system is robust enough to deal with that, that you have an expert panel appointed by Fair Work Australia and you have a potential for a Full Bench and other aspects of Fair Work Australia which can basically take a more proactive position on underperforming funds in the default system. They should be allowed to be given that opportunity. That legislation should be, I guess, encouraged to work and be given an opportunity to work before we venture into other models that don't that system.

MR HARRIS: You actually see the Fair Work Commission acting in place of APRA as the regulator?

MR DALEY: Not as the regulator, but it's in a position where, based on the advice of the expert panel, it should make a decision as to whether or not a fund is a default fund for a particular industry sector. One of the issues that it should have regard to is performance.

MR HARRIS: You are at the – I don't know what percentage it is – but the percentage of the market that's covered by industrial arrangements. We're actually interested in all of the members, the hundred per cent of superannuation where there are a bunch of poorly-performing funds and in some cases presumably the industrial relations system will not be able to act as sort of the default regulator in terms of trying to encourage some merger by saying, "You're no longer registered in the enterprise bargain," or, "You're no longer relevant to an industrial award."

MR DALEY: Our system said that there are processes that allow the Fair Work Commission to cover a hundred per cent of the workforce. There's no limitation on thinking that people who are covered by EBs alone or awards alone are limited to this. There are practical measures that you can have to have a hundred per cent of the workforce covered by the Fair Work Commission process.

MR HARRIS: That would confirm really for me then that you do see the Fair Work Commission as acting as the alternate regulator.

MR DALEY: Well, not regulator as such. Like APRA has a specific role as regulator and a specific inquiry function. It meets with funds on a regular basis and it deals issues on governance and responds to a whole range of issues within the system. It's appropriate to have a number of tests within the system that essentially are there to decide whether or not a fund should continue as a default fund. That's a matter – and we've suggested a number of those in our submission. We don't say that they necessarily are as comprehensive as they might be. But there are an opportunity to put a series of issues in there, performance, governance, a whole range of other standards, which the Fair Work Commission should be able to take into account and determine whether or not a fund should continue as a default fund.

MS CHESTER: Brian, one of the core parts of your submissions today – and we do thank you for your submission and getting it in on time.

MR HARRIS: I didn't say that at the start; I should because I know people have laboured to do this.

MR DALEY: Thank you.

MS CHESTER: Is the role of collective bargaining in default super. It sort of follows on from the point that Peter was making. We're concerned here with the whole default market. Some default members are covered by EBs, some default members are covered by awards and then the rest it's just the employer deciding where to put them. How many then are really – of the two-thirds of super members today that are in default, how many are really covered by your collective bargaining?

MR DALEY: Again, we looked at the current model – and I think that their estimates and even in the Commission's report it was something like 70 per cent of people are covered by the award system at the moment. I think I've seen estimates something of the order of about 50 per cent of the workforce at large could be actively seen to be, I guess, fully covered by the default arrangement. But when you analyse what's out there in the remaining 30 per cent above the 70 per cent many of those people are very easily covered by the award system as it stands at the moment.

Many of those people are misclassified as contractors when they should be employees. Many of those people work in occupations where the award system doesn't necessarily pick them up. But industry identification of those occupations would say that they are within an industry of an employer which could be covered by the way the award system works. It's very easy to extend the award system from 70 per cent to a hundred per cent.

MS CHESTER: Heaven forbid we revisit award coverages in Australia. I think we had a go at that a couple of years ago and government has got that report. But from our perspective then, if being within the industrial system with employees and employers – and we're trying to get full coverage – I guess our model too is probably the closest to the current arrangements, which is employer assisted choice.

MR DALEY: It is, except that one of the industrial participants doesn't get a say in the model.

MS CHESTER: Well, they still could if they work hand in hand with particular likeminded employers. But just bear me out. If we all agree that investment performance is what really matters and getting defaulting members to the best-performing funds, if we all agree that's what matters, and we have an independent body – and we'll come back to the principles in a moment – doesn't model 2 sort of deliver on most of that?

MR DALEY: You're talking about assisted employer choice?

MS CHESTER: Yes. So where the employer can only put their employee, the member, into either one of the short or the long list where we sort of up the ante based on investment performance about who they can choose. And it's an independent body.

MR DALEY: Well, assisted employer choice has some of the features of the industrial system at the moment. It clearly does lack one of those core tenets of the industrial system, that the workforce have got a say in what happens to their industrial arrangements in the workplace. But the other issue that's of significance in this issue is whether or not it's then a workforce-wide issue or whether or not it's better as an industry by industry issue. That's not encompassed in model 2 either.

MS CHESTER: I guess we're dealing with default members who aren't engaged in any way, shape or form.

MR DALEY: They are as soon as they enter the workforce.

MR HARRIS: Can I just clarify that a little bit? You seem to be implying that – and it's a plausible view. I'm not saying it's wrong, but I want to be sure I've got the understanding correctly. You seem to be implying a decision that says model 2, our assisted employer choice model, can't work with the industrial relations system as it is today. Now, I'm not certain of that and I don't think we wrote it up to that effect. I can see why you could argue that some kind of action to also change industrial relations law could achieve that outcome. But just the model itself, just given we are in a phase 2 kind of position – that's the way we look at it, anyway, we're in a phase 2 inquiry where we put up a model.

If the actions that we propose to implement our model 2, assisted employer choice, were taken, that would create a long list of sort of strengthened MySuper kind and a short preferred but not obligatory kind of list. Those lists could then be taken into an industrial relations negotiation, for example, into an EBA, and drawn from – in other words, employers would get guidance from this as to what they could agree to within that circumstance – but it wouldn't prevent the industrial negotiation otherwise taking place around those lists.

MR DALEY: Essentially, you're right. But to this extent the industrial system, in many cases, is beyond the issues of simply, if you like, an employer/union negotiation at every individual workplace in the country. They are then underpinned by conciliation and arbitration and award systems which then basically say, "We have procedures which allow for industry application of those provisions," as opposed to site by site application. That would need to be one of the tenets that occurred within the model.

The name obviously, assisted employer choice, is a bit of a complaint that we would make in naming it because it basically indicates that one party to the system has a say in it. But the fundamental features of a model in which the industrial system chose the outcome could be an adaptation of what you called assisted employer choice.

MR HARRIS: I'm not saying it's written up as that. I'm just saying I just want to be sure, from my perspective at this stage of the inquiry, certainly it's not something that's out of court. But I just want to be sure you didn't know something that I didn't know. Having done workplace relations system and this, I sort of thought I had a reasonable understanding of it. Anyway, sorry, I've interrupted your - - -

MS CHESTER: No, that was a good interruption.

MR DALEY: I did have two other issues I just wanted to raise on the way through. I appreciate time is very - - -

MR HARRIS: I should stop talking.

MR DALEY: We did in our submission urge the Commission to rethink the issue on insurance as part of the characteristics of the default model. Superannuation historically has been a way in which people receive payment for however they left the workforce, whether they were disabled or died. It has become essentially the basis of insurance coverage for – the money basis of insurance coverage for 80 per cent of the workforce. To remove it from the default system leaves a gap in, I guess, a common condition or a common feature of the system, which would be a problem, we think, going forward.

MS CHESTER: Brian, I think it's great that you've raised that in the hearings because I think a lot of people misunderstood how we deal with insurance in the new models. Maybe if I ask a question. The current arrangements in terms of what's required by APRA and the SIS regulations and the Act, the trustees at the moment with insurance, is the ACTU happy with how they're working?

MR DALEY: In a broad sense we are. We're conscious that insurance - - -

MS CHESTER: I know there's some issues.

MR DALEY: Has been a major issue and needs reform. But, yes, we're broadly confident that APRA raises insurance in a proper fashion with funds.

MS CHESTER: Because I guess all of our four models do require that each of the funds to be eligible, to be best in show on the longer list, actually meet all of those obligations. Otherwise you don't even get to the beginning of the race. So we do deal with insurance by saying it's highly regulated. We don't want to go comparing different insurance products. If the trustee is meeting those obligations and they're doing what they need to do by APRA, then, hey, you're up and running and eligible for the different models. So we do deal with insurance, we deal with it in that way. If you're comfortable with the current arrangements – and that's kind of the threshold to get into the competition – then how else would you want us to deal with insurance?

MR DALEY: By simply making it clear that it's a feature of the system. We'd say it's simply a bit opaque at the moment by saying, "Look, it's subject to APRA regulations," which are variable from time to time. But if we're going to make comparisons on default arrangements, then let's make sure we get all the features properly on the table.

MS CHESTER: If it's made clearer that that's an eligibility threshold issue, then that would address your concerns around how we deal with insurance.

MR DALEY: I believe so. The final issue we wanted to raise today is the issue of urging the Commission to think about a default regime for retirement. We think it's an area where people are vulnerable. We think that the system would benefit greatly from a regime in which the default system also applied at that stage.

MS CHESTER: A couple of thoughts there. (1) We're very conscious that the government has got a separate process running around CIPR, the Comprehensive Income Product in Retirement, which Murray kind of intimated might become a soft default. So that's a separate process, but it's one that we'll look at when we get to stage 3 because we agree there's no use doing a great job in accumulation if you then get the product and tailoring wrong for the retiree. I guess we're very mindful though that at the moment in retirement there's a world of choice.

MR DALEY: Non-default arrangements are not suiting public policy goals in retirement and there should be a discussion about whether alternate systems would help overcome some of those issues.

MR HARRIS: There's not a strong incentive for your current fund, whatever it is, when you hit the point at which you want to start converting to being a retiree – there's not a strong incentive for them to offer you a good product just simply for the purposes of ensuring that they don't go through this cash flow problem that you were alluding to earlier when we were talking about coming up with a relatively small number of default members?

MR DALEY: All funds offer services and extensive services to people at that stage. We are seeing incredible leakage from that system. We're actually also seeing, I guess, a considerable dilation of the asset allocation issues that occur post-retirement as well too. That's one of the factors leading to a potentially significant underperformance against, if you like, national policy objectives.

MR HARRIS: First-timers pool, our concept of just converting that, now, unless I missed it, I didn't hear – and I may have – I'd like to get a view from the ACTU on shifting to once-only default arrangements.

MR DALEY: We've supported the concept. In our submission we've supported the concept of the way in which, if you like, MyGov and Single Touch Payroll will identify a single fund for a person. That idea, which I guess flows from the first timer default model, is a concept, we think, is a worthy concept and a way in which the system should mature going forward. Now, how you get that person into that chosen or default fund within the sort of MyGov listings and things is an issue that's open for some considerations. But the aim of first default appears to us to get people into that system. We think there are better ways of getting people in that system but once they're in that system we think the system is a worthy development.

MR HARRIS: Thanks.

MS CHESTER: How do we then deal with where people can't default out of a product once they've defaulted into it, so the 20 per cent that are kind of – if they move on to another job – what was really interesting is I think for the first time ever the Commission in our media release for a draft report said we'd like to actually hear from young Australians and their parents who might be interested in their wellbeing in the super system. We actually got quite a few submissions where they said that there's a frustration, even with the MyGov and the ATO helping with account proliferation and consolidation, that some people just can't consolidate everything. They can't because of some of the EBA arrangements and some of the award arrangements. How do we deal with those if we don't require – so we agree with further streamline arrangements with the ATO. But if we don't make it a rule that you default once unless you choose to go somewhere else, how do we get rid of the multiple accounts?

MR DALEY: In most cases consolidation is not a difficulty under any part of the system at the moment. Awards per se as opposed to agreements generally don't prescribe that an employee has no choice or no ability to consolidate in a fund that might be not one of the ones named in defaults. There is an issue about whether or not enterprise bargaining agreements prescribe a single fund – and the government has proposed legislation to deal with that. That legislation failed because the parliament lapsed. If that legislation was dealt with in a new parliament, then that would be, I think in our view, the only part of a system that at the moment limits people from being able to completely consolidate.

MS CHESTER: I'd welcome you to read some of the subs we're getting from some young Australian, including Michelle MacDonald and Tim Limmings, because they're kind of suggesting it's a bit tough for them to do that at the moment. I just wanted to ask a couple more quick questions. We set out some principles for the body or the expert panel that would help us get to the best performing funds, be it a short list or a longer list; MySuper on steroids, some have suggested. It would be good to get ACTU's view on those principles.

MR DALEY: I don't have an answer for you today on that, Karen. I can take it on notice, if you like. We've obviously made a comment in respect of partisanship in this and we've sort of taken, if you like, a bit of exception to the Commission saying that, "Look, the only people you'd want to exclude are employees and employers from expert panels" – employee representatives and employers from expert panels because, your view, that that's where partisanship exists. But having said that, there have been significant issues in identifying expert panels at Fair Work Australia.

It is difficult to find people with adequate knowledge, background who have no conflicts of interest at all in this model. The problem with identifying an expert panel has been the pool becomes so small that it becomes difficult to identify. But we're happy to basically have another look at that and, if appropriate, provide a comment for you.

MS CHESTER: It's really the practicalities of getting the independent non-conflicted members of that panel that causes you concern?

MR DALEY: Our more overt comment was that the history of appointments to these panels in recent times has been completely partisan and, on that basis, no one would have any great confidence that a panel appointed under this process at the moment would be other than politically partisan.

MS CHESTER: We had one terrific suggestion from PWC in a submission that they gave us. And it comes back to one of our last principles and making sure that there's accountability with the decisions that any such panel would make, because accountability is kind of the best way to make sure that they are acting in the members' interests and they are independent and truly non-conflicted. PWC – and it's a really good suggestion – said that the ultimate way of getting that accountability was for that panel, after they've made their decision – so after they've locked and loaded – then there has to be disclosure of the decision-making. Would that address your concerns?

MR DALEY: It may do. We think that, again, there is a process already in place where the expert panel's work is reviewed by a Full Bench of Fair Work Australia. That level of independent scrutiny, taking into account, if you like, superannuation and non-superannuation factors, is a way of providing a second set of eyes over the panel's decision. We think that's the most preferable system at the moment.

MR HARRIS: It seems to me, just as an observation, that partisan appointments are an accusation that occurs regularly within the workplace relations system as well and we commented on our workplace relations report at length. You almost in principle rule out any expert advice if you say, "You may be an expert but there's a fear you'll be partisan." It sort of like says, "Well, there's no solutions here," rather than perhaps the wise regulator will come in and choose – and we have had that suggestion, which may be why I asked at the outset who you sought as a regulator and I can see that you lean towards the workplace relations system.

But it's been suggested that APRA itself could actually do this now. We find that a potential conflict with their own role otherwise in terms of both selecting winners and then scrutinising them. It's somewhat problematic. So really the observation I'd make on the accusation of partisanship is it can be made against any human choice whatsoever when it really appears to be a default argument which says, "Well, then just leave everything alone and we'll pray that members work out the matter for themselves." That's quite hard to say because you've got a lot of members right now not making any choices at all.

MR DALEY: Beyond pray, we've got a history of 30 years of performance where the system hasn't been, I guess, accused of partisanship.

MR HARRIS: It's not just partisanship, I was worried about members again. I'm back to members and the performance. We do have a lot of members who are not making any decisions in their own interests and are staying in funds which are not performing well. They are not just any particular kind of fund, for profit or not-for-profit. We have this stickiness of members and lack of information that seems to be readily accepted by people taking what are quite complex financial decisions over a very long-term period.

Normally you would expect that there would be a better information flow encouraged in some way which could, for example – take our model 2, our employer assisted choice, it actually has a better information outer kind of selection process and a preferred group, which is, again, better information. And you might encourage members to pay greater attention to it simply by the publication of that information as well as employers. I guess I'm still saying even that has some form of panel inside it, therefore, all of those panels are subject to exactly the same problem, aren't they, that one party or other can simply say, "This is clearly biased."

MR DALEY: There seems to be to me a bit of a problem in definition in this in that the Commission is basically saying, "Look, we're interested in first starters and a default arrangement for those people and that's where the recommendations end."

MR HARRIS: That's because that's what this phase is about.

MR DALEY: And that's what we've set about doing, alternate default models for superannuation. We're not in a situation of sort of saying, "Are we providing really good choice options and information for 42-year-olds changing their job for the fifth time in their workplace and are they getting out of default arrangements and consolidating properly?" What we're doing is establishing a system for the default people at the start and then the rest of the system on how people will get information, change funds default, move when they change jobs will be the same as it is now.

MS CHESTER: I think that's where we probably differ in how we're viewing the role of the new alternative model. We would actually see the existing system benefiting greatly from the greater information and transparency around performance in the new alternative models that the elevated role of the ATO in saying, "Well, here's the best in show. This is what their track record is like and this is what they're offering." Also, the requirement that if a super fund does get best in show, they have to offer the benefits to their existing default members. So we do see this better fitting the entire system, not just the new job entrant.

MR DALEY: Funds do offer consistent terms to default members and non-default members. That's already a feature of most of the default arrangements that are in place now. But it's not as though, having established a best in show gong, is then going to change the mindset of a 17-year-old joining the café for the first time who's going to say, "Gee, I wonder who the Commission's recommended for these funds and whether I should pick X, Y, Z from the defaults." They will basically be defaulted the way in which people are essentially currently defaulted now and their choice regime will emerge later in their working life. Whatever information you provide about the best default funds at that stage is a bit of a leap beyond what we're doing with the default people at the start.

MS CHESTER: I guess the one risk we're trying to mitigate – and, indeed, it's a shared view with one of the largest industry super fund submissions to us is the greatest risk for a default member is being defaulted into a poor-performing product. Do you agree with that?

MR DALEY: Yes is the answer.

MS CHESTER: I just have one more quick query or question and then we're already running late, which is going to be my fault now. Mergers. I got a sense from reading the ACTU submission, Brian, that you guys are pretty comfortable with how mergers are dealt with at the moment. You identify a commonality of interest between the merger partners as being quite important when we made this recommendation about greater merger disclosure.

MR DALEY: Yes.

MS CHESTER: I just wanted to get a kind of understanding is what would be some examples of commonality of interest between the merger parties?

MR DALEY: Some of it may well go to the demographics around memberships. Often a feature in the way in which, I guess, the parties have historically talked about mergers it's often been people who worked in aligned industries who have common workers in those industries as a basis for wanting to talk about a merger if a smaller fund wants to, I guess, basically have a different future than what it's got at the moment. Yes, I think it's that sort of – part of that is an automatic flow in demography. But it's often an alignment in industry characteristics is probably the most significant feature that we've seen.

MS CHESTER: I guess if we're dealing with a default member and it's a pretty sort of basic product that they would need – it needs to have good long-term investment performance, good intra-fund advice, good admin services - - -

MR HARRIS: Good insurance.

MS CHESTER: And adding in that they meet their requirements under insurance, then I guess would any merger that resulted in one of the members for one merging party would benefit from greater investment performance through – although a cost through the merger, it wouldn't necessarily be based – I'm just trying to understand. People say you need to differentiate the default product based on members, industry and demography. If it's kind of like a basic product and you just want good investment performance, I just struggle with that one.

MR DALEY: There's clearly an underlying feature at the moment where small and medium sized funds are in positions where, I guess, positive cash flow is under question and therefore their ability to basically deliver the asset allocations that deliver the long-term performance that's never consistent are under consideration. That's an overarching factor. It's sort of a given factor that for the medium-sized funds moving into a larger fund with a larger cash flow and a more stable asset allocation is probably going to improve long-term performance.

I think that is a common feature and a given feature and a feature which shouldn't be discarded but is a feature that's an important part of why mergers happen. Having taken that as a given as to why you're doing it, it's then a matter of which are the best alignments that you might have going forward that will make the merge the most successful that you can?

MR HARRIS: I'm done. Are you okay?

MS CHESTER: I'm done.

MR HARRIS: Brian, thank you very much for your participation of the ACTU's submission to this. Hopefully you'll stick with us through phase 3 as well.

MR DALEY: Certainly will do.

MR HARRIS: Industry Super Australia I think is next. Once you settle, for the record, if you guys could identify yourselves, that would be good. Thanks.

MR MAY: Good morning, Chairman Harris, Deputy Chairman Chester.

I'm Zak May with Industry Super Australia and I'm joined by Matt Linden who's the Director of Public Affairs for Industry Super Australia. We're really grateful for the opportunity to appear today. We think Australia's superannuation system sits upon a very strong foundation, a very strong cornerstone of compulsory savings with guaranteed minimum contributions enforced by the Superannuation Guarantee and supplemented by collective agreement at the industrial and enterprise level. If building and maintaining a strong funded retirement income system involves more than merely placing savings into the system, these savings placed in the system need to be connected to high quality providers that deliver the appropriate benefits to members.

The inquiry has been asked to develop an alternative to the current way of connecting savings to providers, at least for default members. But thankfully, the inquiry is not starting with a blank slate. Superannuation has been around for decades in Australia and many times that in other past economies. There is an enormous and rich body of real world experience and evidence about what works and what doesn't work here in this country and elsewhere. Tapping into this body of evidence and performing detailed rigorous analysis would be of great benefit to the inquiry. First, it would help to inform the inquiry and help to focus on the key policy and institutional settings that the best-performing systems have in common. Second, it would alert the inquiry to the key risks and problems that plague the poorer-performing systems.

Now, around the world there are essentially three ways of connecting savings to providers. One way is to permit consumers to choose their own product supported by laws regulating disclosure and selling practices. This is the approach for the main part of the United States, although it's changing, and in Mexico, among other countries. The second way involves the government selecting one or more funds through a tender or auction process such as in Chile or New Zealand. A third way involves industrial parties either employers or in some countries the so-called social partners creating the providers for workers and specifying those providers. This is the approach in the Netherlands, Denmark and some other countries. In these countries the providers are not-for-profit.

In many countries, including Australia, more than one of these different approaches might be used. The choice between these approaches can make all the difference between a comfortable and secure retirement for most people or something else, or, to borrow from something (indistinct) said in the past, it makes the difference between steak and spaghetti. This cross-country evidence about the performance of these different approaches – retail choice and government selection process or industrial model process – are strong. There's strong evidence about how they perform. Jurisdiction with not-for-profit providers where workers are allocated the products under the aegis of the industrial parties subject to strong government regulation substantially outperform over the long term.

The very best funded retirement income systems in the world – Denmark and the Netherlands – operate in this way and the best performing part of the Australian system also uses this approach. However, in government tender or auction countries only mediocre outcomes are obtained because the private providers are often for profit, or actually they are for profit, and the selection systems have not prevented these providers from capturing value for themselves. This is shown in Chile where the providers have captured the spread between changes in operating fees and costs.

In addition, where the government is responsible for selecting funds there is a tendency to seek to minimise the risk to the government of choosing a bad fund rather than trying to maximise outcomes for members, as this may have been the case in New Zealand. Systems based on consumer choice are even worse. In Mexico the IMF have stated that their change to the system has "resulted in destruction of value". Of course, in Australia retail choice products underperform on average over long term and so do the vast majority of self-managed super funds.

A detailed investigation of systems' architecture and why different systems work well also would help the inquiry to identify the key challenges that the underperforming systems have. The poorer performing systems tend to perform poorly not just because individuals are poorly suited to managing the risks relating to providing themselves a retirement income and making relevant decisions, it is also because more private providers operate in these markets and seek to extract value for themselves. Indeed, in the real world it seems to us that choice is just a rosy word for "sales". In the real world they are two sides of the same coin.

It is hard to see that there could be any other explanation unless millions of people in this country and around the world, including millions of choice and SMF members of this country, have affirmatively chosen to be poor. Looking at the real world experience also makes it clear that the laws governing default selection is not a platonic system that operates disconnected from the participants and politics and other interests. Quite to the contrary, these laws are intensely political and the potential profits that banks and wealth management businesses can extract from these systems are enormous.

These commercial imperatives result in unrelenting direct lobbying by banks to change the system and indirect sales and marketing efforts to pull members out of any default system after combined with regulatory arbitrage to facilitate this. This is perhaps the area where the inquiry could make the greatest strides between now and the final report. To see superannuation in its evolutionary context which recognises the important functions that trade unions and political groups play in countries with high-quality superannuation systems. These groups pay a role not just in resisting financial sector lobbying, they're playing a role in that deliberation, but also reinforcing the cultural and (indistinct) funds who often (indistinct) out from the finance sector.

Another area the inquiry may wish to focus on between now and the final report is to test every way that for-profit providers might be able to seek to undermine the draft report's proposals and to use those proposals to their commercial advantages. Each of those alternative models in the draft report envisions a system where private sector and for-profit financial institutions can bid for and win pools of default superannuation or assisted choice members. Such an outcome will deliver to these providers a readymade government-sanctioned customer base and a very low acquisition cost.

Once those customer bases are acquired these institutions will upsell across other products. Today sophisticated members under professional advice enter into these products and wind up poor, yet the draft alternatives would furnish for-profit institutions with a customer base of less engaged default members who are likely to be even more susceptible to being sold products that may not be in their best interests and leave them worse off as well. Thank you for hearing our opening remarks and we are very pleased to answer any questions you might have.

MR HARRIS: Thanks very much. Again, we want to acknowledge your effort in putting in information to the inquiry. Since I may forget to put the ad in again, hopefully you'll stick with us through phase 3.

MR MAY: Certainly, Chairman, thank you.

MR HARRIS: You said in the opening remarks as an interesting way of looking at things, choice is just a rosy word for "sales". It does rather suggest that if we stepped outside superannuation where this terms has perhaps become passionately used – and I won't necessarily say partisan because we've already had a fiddle with partisan today – but this term "choices" is a matter that inflames passions. But in the remainder of the economy the ability to exercise choice seems to still be pretty widely accepted as a fundamentally good thing for individuals, even though they may not be necessarily fully versed in the nature of mobile telephony or the nature of electricity provision or things like that. We're still all in favour of choice, aren't we, he says hopefully?

MR MAY: I think you have to be very careful about how individual autonomy is manifested and how people make choices and realise (indistinct). There are many instances where people are quite well equipped to engage in product and other sorts of decisions. Telephony, they may not need to understand the back office, but they can make decisions here and now about that service, understand what's valuable to them, what the utility is and they have repeat opportunities to learn. They can compare relatively quickly about what is there. And the cost of getting it wrong aren't that significant.

I think there are a number of distinctions between those kind of product markets and what we see in superannuation where the information is much different, the opportunity to learn from the experience is difficult, the information symmetry is vastly higher about what even the benefits are that you're engaging with. I just look at the empirical evidence of what happens, Chairman, when people do make choices; they generally wind up poor, and significantly so. It's got to be that balance between providing people with individual agency, on the one hand, where it actually does real benefits for them and it's not just an appearance that we're giving you choice, to actually get something good out of it. On the one hand, they're achieving the social policy outcomes behind this system. We have significant tax concessions here and government is using its mandating power to correct behaviour to get an outcome.

MR HARRIS: Since you touched on mandate, that was going to be the second part of my question. The other reason presumably we do actually favour the existence of a wide variety of choice and legislative support for it is because this is also mandatory, so it's you are required. Unlike mobile telephony – I suppose electricity is pretty close too, you can hardly function without it. But, nevertheless, it's not mandatory to have electricity but it is mandatory to give over a chunk of your pay to a superannuation provider. It seems to be, I would have thought, a highly defensible offset to the mandatory nature of this that you do actually have the ability – perhaps you don't have necessarily the capability – but you have the will to choose. Surely we wouldn't want to just denigrate choice as being a poor - - -

MR MAY: If you can get good outcomes from people, then that would be better. But, again, I come back to the evidence. It's making people poorer in general. What you want to do is to – and we tried to touch on some of these options for you to consider and I'm sure you might be able to come up with other better ideas. But where people are – to both ensure that the products that are available for people to choose are presented to them in a way that isn't designed to result in bad outcomes for them – there might be some exploration of individual's capability of actually making good financial decisions, not just self-assessed confidence, but actual measured capability to make those kinds of decisions and an ability to withstand losses if they happen to make a mistake.

There are a number of things that other jurisdictions – and we can explore them here – to try and have an outcomes-oriented ecosystem that does allow for choice that delivers good results.

MR HARRIS: I'm happy to accept your qualification or perhaps – I'm only labouring the point because it seems to me no one could fundamentally disagree that this is advisable in some form. We can argue about the form.

MR LINDEN: Could I just add a few further remarks? I think probably one of the key things to consider in the context of choice is how market participants respond, how they structure their products in light of choice. Obviously the inquiry is very familiar with the issues associated with behavioural finance and the information asymmetries. What we can see in the superannuation market at the moment is that there is no shortage of choice products and choice investment products. There's tens of thousands investment options. How anyone can make sense of those is beyond me.

But, nevertheless, we see some parts of the industry obviously hang their shingle up around offering choice and product tailoring. I think the purposes for them to doing so are not necessarily aligned with delivering the best possible retirement outcomes.

MS CHESTER: I think we all can agree that performance is kind of what matters and meaningful choice across high-performance products, which is kind of what we're trying to do in stage 2 here. Can I ask you, do you agree that – our stage 3 is kind of like the end product here and it's about competitiveness and efficiency and you say competition only matters if it delivers efficiency – does Industry Super Australia agree that efficiency is important to deliver performance outcomes for members?

MR MAY: Absolutely. In fact, as you've just done in that characterisation, efficiency or the net benefits to members over their lifetime is the determining factor, not competition.

MS CHESTER: So I don't lose my train of thought, sorry, the other systems that Industry Super Australia refers to in your submissions and your other participations in our inquiry, how have they been assessed in terms of efficiency?

MR MAY: We can look at the net returns that are present in those systems, and they are higher on average over the long term.

MS CHESTER: Set aside net investment performance, just efficiency. We're going to have to look at how we measure efficiency. Your submission refers to these other global systems that don't have choice but they're best in show globally. I think we're all familiar with the Mercer Global Index. I'm just wondering how is efficiency measured when those systems have been ranked and assessed?

MR MAY: I think that, again, the measure is are the contributions received into the system, what financial outcome are you generating for people? There are two aspects of efficiency. One is the net return on that. Then there are other kinds of risk (indistinct) efficiencies that some lifetime systems have. But we just focus on the returns, I think that is the determining characteristic of whether you have an efficient system.

MS CHESTER: And maybe I'm going to be labouring this point too much, but I kind of then went back and had a look at what was in that Mercer index. Couldn't find efficiency.

MR MAY: You don't need to look in the Mercer index. You can look at the OECD pension we provide in our submission which set out the long-term net returns for those different jurisdictions, and indicated they were higher than our own. They're higher than Chile's, they're higher than New Zealand's.

MS CHESTER: But none of them measure efficiency. That's okay, we're going to get to that in stage 3. Now, I'm going to take us back to some mind-numbingly boring process things so I can just kind of understand the status of your submission. Zak, just remind me, how many industry super funds are there all up at the moment?

MR MAY: I can't recall off the top of my head the number of not-for-profit funds. I think it's around 109, and those would be characterised as industry funds.

MS CHESTER: When we're reading your submission, how many of the industry super funds does your submission represent the views of?

MR MAY: It's an interesting question. We work closely with 15 but we also consult probably with other funds. I think you should take our submission as reflecting the views of ISA.

MS CHESTER: So it doesn't reflect the views of industry funds?

MR MAY: I would say it does, but I think particularly under the time constraints to consult with them, but our views are ISA's views.

MS CHESTER: So there hasn't been a process where your 15 members have signed off on your - - -

MR MAY: They've certainly seen drafts and consulted on it. We don't operate in that sort of a manner.

MS CHESTER: The only reason I ask is because we've had the joy of very quickly cantering through the 30-plus subs that we've received since Friday and there's two large industry funds that depart from the ISA view on the models. And I'll probably come back to that a little bit later, but one of them, indeed, supports model 2, assisted employer choice, and one is very supportive of – actually one of your 15, I think, one of your larger 15 – supports key elements of model 1 and 2, that is, the short list. So I'm just trying to work out - - -

MR MAY: They're certainly entitled to their views and we'll circle with them and we'll all try and get on the same page.

MS CHESTER: That's enough of boring process questions. Now, you'll know what my super question is going to be here, Zak, because I saw you in the backrow when I asked it of Brian. So maybe I don't even need to ask it again. But I will for the transcript.

MR HARRIS: For the benefit of everybody, Karen is going to ask this question to every (indistinct) because Karen is a structured process type person and I am the just wander all over the place.

MS CHESTER: I guess does Industry Super Australia agree – the question is, do you think poor-performing funds, if they're poor performing over a substantive period of time, should exit and should new entrants that have got a demonstrated track record of high performance should be able to enter and provide a default super product? I just want a yes/no answer.

MR MAY: You may want a yes/no answer but - - -

MS CHESTER: Just give me the yes/no answer and then you can give me the caveats but I want the yes/no first.

MR MAY: Yes, but – and this is why it's really important – let's start with some facts because we've always supported this, but it's important to think about it from a public policy perspective and from the interest of members. What does it mean for a fund to be poorly performing and what's the appropriate response to that and when do you decide that they exit? If you just nipped back and looked at the five year - again, performance is the strongest factor, in our view, and if you just start with that. Let's say you had five years of net returns up to 2011 and you looked at the funds in the bottom quartile and said, "If you're in the bottom quartile, you're out," and then look again in the five years to 2016 and see how many of those funds are still there.

If you applied that cut and taken them out, would they still have bad performing funds or did you need to give them a chance to rehabilitate? What's better for members, trying to allow a fund to rehabilitate or getting them out as soon as you have five years of net returns? I think those are the difficult questions that you have to explore before you say, "You're out." But at the end of the day, if you have been given an appropriate opportunity to rehabilitate and you're not delivering for members, then you need to no longer be managing those members' services.

MS CHESTER: Because I'm conscious of time, that's why I left it as a simple principle question. Do you think, regardless that you might get there one day – one of the key things in your post-draft report submission is the theme that the risk that initial default fund a person joins when they begin employment might not be ideal later. It comes back to this point that I'm struggling with about just because somebody changes a job, if they're in a good default product now or in 15 years' time or they get older, why would you need to differentiate the default product for them during the accumulation phase?

MR MAY: I'm happy to hear Matt's comments on this as well. When you think about what a default product is or any superannuation product is, two buckets of things are being provided there. One is the investment management piece and the other is the administration, disclosure, connection with community, education, those kinds of things. Even in a default product, as much as you might want to strip that second part back, there is something to it and there are different ways of communicating with people who have different levels of education. There are different ways of communicating and engaging in the community or different industries have different gender balances.

Then if you're looking in the future where you might have, aside from insurance, other forms of mortality pools, those become important factors.

So it's not just investment management that a default fund provides and those characteristics, education, gender balance - - -

MS CHESTER: Our best in show have to meet all of those as well. I'm just trying to work out - - -

MR MAY: That actually varies based on industry. Maybe I'm not answering your question. I apologise if not. You can think about a default system that looks at the national level or you think about a default system that (indistinct) by industry and there are additional value-adds on the administrative side of segmenting by industry because there are industry characteristics that differ from the broad national pool in terms of gender, education and other forms of relevant background areas.

MS CHESTER: Apart from member communication, what is it – if we all agree investment performance is kind of the be all and end all in the accumulation phase, what changes with age and with industry sector that means that if you've got a good investment performing default product you should move to another one because you've moved job?

MR MAY: You are having a fund which provides a topic for a broad range of people. You can provide a national fund or you can provide a fund setting for a particular segment of the economy that has a large number of women or a segment or a fund that caters to a large segment of the economy that has workers with higher levels of education or lower levels of education and you can provide different kinds of ways of engaging with them and explaining what their benefits are.

MS CHESTER: I said separate to – I'm just trying to understand it for the investment performance.

MR MAY: Just for the investment piece, from that perspective, we think that the investment approach should be relatively homogenous for all folks.

MS CHESTER: That's helpful to know. Would you agree then that maybe the biggest risk is just defaulting someone into a poor-performing product?

MR MAY: Not right now because the number of default products that are poorly performing is relatively low.

MS CHESTER: Overall, regardless of current metrics, is the biggest risk going forward defaulting someone into a poor-performing product?

MR MAY: No, I think the biggest risk is having people who have been defaulted into a product being extracted from that product and put into a poor-performing fund that is not their default. That's what we're seeing in the existing system. That's the greatest weakness in the existing superannuation system is the movement of members from high-performing default funds into a more poorly-performing - - -

MS CHESTER: I think we're agreeing, but we're getting caught up in semantics.

MR HARRIS: I'd be interested in that because it's sort of consistent with what I asked the ACTU a bit earlier. As Karen points out, we do have widely different views even amongst industry funds on what is the biggest risk. We're not saying who's right and who's wrong. I'm just trying to say it's not just us arguing. That's why curiosity is substantial here and, again, because we keep thinking about members – and I know everybody does, so that's not just – we keep thinking about members.

Do you have then some data which suggests that there are lots of people who have been moved from well-performing funds to poorly-performing funds? In other words, we don't see the amount of churn that you seem to be implying. We see a lot of people who are relatively stable in the superannuation system and when they move on to another job they get stuck in another fund and so, remarkably – and I know efforts have been made to try and help them reduce account proliferation. But we see that as being substantially a problem, and so do all other people who you encounter in an anecdotal sense.

But you emphasised data. So I'm interested in this data question. How much can you actually observe of people being taken out of what you might consider to be a highly desirable fund and put into a demonstrably poorer-performing fund.

MS CHESTER: And remember we're only interested in default members here. Within the default segment, where is that occurring?

MR HARRIS: We know the industry does sort of have data that isn't published by the primary regulators that we can talk to. We've been looking for database sources. So even if they're sort of like some kind of Rice Warner advice that you've got from somewhere, is there something that supports what you just said? You said that's the biggest risk.

MR MAY: I think that there's two parts to your question. I saw Matt start to get ready to answer the one about the data around transferring out of default funds and I can think of some data on that as well. But I'll ask

Matt to cover that one. Just quickly on the multiple accounts characterisation though, and this is one of the things we were surprised in the draft report was the characterisation of multiple accounts as the (indistinct) and emerges out of the default system. When you actually look at the propensity of inactive accounts by segment – so if you look in the retail sector, for example, the percentage of accounts in the retail sector that are inactive is actually higher than the percentage of accounts that are inactive in the not-for-profit sector, which is I'm sure it's surprising because the way it's been interpreted is that this is something about - - -

MS CHESTER: You're getting into stage 3 territory. We're just focusing on default here. Our report was about - - -

MR HARRIS: I can happily accept, since it's my question, Karen, that both retail and industry funds might have differing but, nevertheless, in our view, substantially undesirable proliferating of accounts. We are not here to say retail is horrible or industry is horrible. We're just trying to worry about members collectively and go, "Gee, proliferation doesn't seem to be in their interests."

MR MAY: We totally agree with that, Chairman. I apologise, the reason why I was making that point was not to cast aspersions. It was to say that the driving factor between inactive accounts is because of some of the behavioural risks around members that we wanted to (indistinct) in the introductory comments around inertia, a difficulty of remaining engaged. It wasn't to say that – and it's not a distribution model issue. It's just how people are.

MR HARRIS: I agree with that. The data question?

MR LINDEN: I'll come back to that.

MR HARRIS: Even if you don't have it with you, there's a hint here.

MR LINDEN: What I just wanted to say, what we'd encourage the inquiry to think about is – and thinking about models that have been put forward – how the market participants are going to respond, what sorts of incentives might there be to do certain things, particularly in thinking about these models that are being put forward. In our submission we make the point that in opening up the default market, in effect, will monetise default pools, certainly under some of the models. And how will some of the market participants respond to that?

I think one of the things which you're trying to emphasise is for the inquiry to think about whether or not there are adequate safeguards in the model that are being put forward as to what will be foreseeable behaviour. Now, coming back to the point about stage 3 – and I think this is maybe where we have a difference of opinion, obviously. You're working to the terms of reference which the inquiry has been given. We respectfully and we have respectfully said that it's the wrong way around.

MR HARRIS: I accept that our terms of reference are weird but we're not allowed to say this.

MR LINDEN: If we were to have a discussion about where the greatest gain is to be made in our system in terms of efficiency, we would not be looking at the default segment.

MS CHESTER: Matt, don't worry, we're not going to deprive you of the joy of that discussion, we're just going to have it in about nine months' time when we do actually look at perhaps one preferred model or two preferred models against the current arrangements. We will get there and you'll be sick of us by that stage, I'm sure. On the point that you make about the behaviour of participants, it was something we're very mindful of in the draft report; indeed, we had an information request about it. We do feel that there would need to be an elevation in certain prohibitions. So I think what you're getting at is kind of like the bait and switch issue, particularly if we allow some folk that offer more than one product into the default market.

We're in the same mindset that you are in terms of let's come up with the best belts and braces, mindful that that might occur, as to how we can stop that from occurring. PWC submission – and, again, I'm hoping a lot of people might read the submission because it was a really helpful one – came up with a few suggestions in response to that information request. Greater controls on inducements around non-super and member non-benefit products. They pointed to the FOFA best interest test being a new obligation that would apply here. They also suggested reporting to APRA in movement of members from default to related-provider products and then, of course, the current member best interest obligation. We would expect to see the regulator issue some greater guidance about how that would need to be achieved in a world of a person with related products entering into the default market.

It would be good to get your sense of those protections and whether they would address – so we have the same issue. We're conscious that there will be behavioural responses in different markets. What would your initial sense be around some of those protections?

MR MAY: If I may, I did promise that I'd give a little bit of information around the movement out of funds and then I'll come back to that one. Movement out of funds, I think that there's one publicly available source, at least, and then there's fund level information. On publicly available source there's a research house, Roy Morgan, which looks at the source of advice that is provided to members and what induces them to choose and then the different channels that wealth management firms use to draw people from. More potentially informative to the question you have asked would be fund-by-fund inquiries. Funds do keep careful information about when their members leave, where they go. If you were to ask industry funds about who their default members are and where those default members go they would be able to tell you.

MS CHESTER: These are members that choose to switch versus members that just end up in another fund because they've moved job?

MR MAY: The former.

MR HARRIS: Sorry to interrupt. Tell me to shut up if I'm – but you're not aware of some kind of like – because there's only relatively few advisers in the industry to most of these questions, you're not aware of anybody having ever, for example, offered you advice that aggregates it across a suite of funds or something like that? I'm trying to get to your question about the different risk.

MR LINDEN: We may well be able to talk to the funds about where members might be going within the system and provide some more information. There is that Roy Morgan survey. On the issue of multiple accounts, obviously in the submission we've made we've suggested a more vigorous and aggressive approach than the Productivity Commission has suggested. This is a discussion which has been going on for a long time around multiple accounts. In our submissions to the Cooper Review we said there needs to be a process of automatic consolidation. We recognise there's been improvements, obviously, with the ATO, with MyGov and the ability for people to see whether they've got accounts. I think the jury is still out on whether or not that's really that effective.

Our view would be if we want to ensure that we don't have two and a half or three on average multiple accounts per person, there needs to be auto-consolidation. Some parts of the industry have resisted that fiercely and you might be aware of some of the discussions, in fact, which are going at the moment around insurance is one of the reasons which were given for why auto-consolidation should not occur. But we've obviously suggested that there's a mechanism whereby there can be an opt out. So if someone knows that they're maintaining multiple accounts because of wanting to maintain particular insurance, then they'd be given the opportunity to opt out of auto-consolidation. But we think auto-consolidation in a market where most people are disengaged would, in fact, be the best approach and the benefits and cost savings would be significantly greater than the model that's been put forward.

MS CHESTER: I guess what we're trying to achieve is the same in terms of auto-consolidation. Your auto-consolidation is kind of like a going forward auto-consolidation, isn't it? So if you move a job, there's a new default product you're into and then everything hoovers across unless you opt to leave it there. Is that right? I guess what we're trying to do is the same thing, but we're wanting to make sure that auto-consolidation happens in the best performing default product for that member. So when you come back to us on the metrics around the examples of people that have been in default products that have moved into less desirable products, what we're focusing on here is within the default sector.

MR HARRIS: We're genuinely interested in this less desirable I think is another way of putting it. In other words, it can't just be they've moved. Because the allegation is really that there's a lot of bait and switch kind of tactics. We've got you and then we upsell you or we send you on to some kind of wrong fund for your interest where we earn more money. I'm just interested in knowing whether it's – because it's, of course, a rumoured problem. The question is, can we substantiate it as being a problem because – and then because we're asking the primary question, what's the risk here that we're meant to be addressing in default super as we make changes? You can say there's lots of risks. I'm just very interested in the one that we've generally settled on as being, is it accurate? That's this primary risk of - - -

MS CHESTER: We're agreeing now that we're going to have two sets of metrics from you, one where there's a bait and switch occurring – and that's obviously where someone's entered the choice market – or within the default segment someone's defaulted into a new product, consolidated, and that's a lower-performing default product, which is kind of what these models are about.

MR HARRIS: To the extent that that information is available, because we are quite familiar with the fact – can I just ask one question on your auto-consolidation sort of thing?

MR MAY: Yes.

MR HARRIS: As you know, we refer to the fact of the existence of SuperStream now in place. If you previously took this position in response to Cooper, then you wouldn't have had that option in front of you and wouldn't be a live existing arrangement. So today we're in a position, it seems somewhat, where the ATO is able to – it isn't charged with – it is able to exercise some activity. Would you see auto-consolidation triggered by a – or would you see it as being viable to see it triggered by the ATO? In other words, a person encountering in their second job the start-up of another fund and the ATO sending a crew back to the employer which says, "Tell me that this person has decided to have two funds rather than one." I'm just making it up, I'm making it up for a response to your position.

MR LINDEN: Look, I'm conscious and I think today there's a Senate Inquiry report that's been released into unpaid superannuation where the ATO figures highly. We know, of course, there's at the moment a framework around lost and inactive accounts, which the ATO – they are actually budget-savings measures to (indistinct) out of the system lost and inactive accounts. My understanding is the ATO is not being proactive in reconnecting those lost and inactive savings with an active superannuation account. So there may be incentives on the part of government and the ATO to keep money at the moment within those – I mean, my understanding of the budget (indistinct) is that it's booked to non-tax revenue when those moneys come in the door and expense when they need to be paid into accounts. There's some peculiar incentives in there at the moment in terms of whether or not there's an incentive for the ATO to reconnect members to savings.

MS CHESTER: It's interesting in that context. You guys would be familiar with the New Zealand clearing house model.

MR LINDEN: Yes.

MS CHESTER: Where effectively their version of the ATO, if there's non-payment, they have to underwrite it. So there's really a set of eyes to make sure the employer is paying up. It would be good to get your views on the clearing house model. I know some of your – one of your members has supported it. Because it addresses a whole bunch of these problems and issues that, as you pointed out, perhaps progress is being made, but we've actually said in our report it's been a little too little too late.

MR MAY: I guess on the clearing house function, I mean, if you think about a payment system and clearance of that, you have – in SuperStream you have multiple clearing houses have been built. Then the question is, do you need to build a new national clearing house through the ATO at this time? What happens to the existing infrastructure that has been built and what's the additional benefit? If it's things like underwriting performance of payment, that's different from a clearing house function. Clearing house are just connecting payments between institutions and then recording the data around that.

MS CHESTER: We say in our report clearing house continues in the model, and we spent some time over there chatting with them about it.

MR MAY: That's all I was trying to say is there's a couple of things going on here. One is the system to enable the transfer of payments and the recording of data. I think that's been built in with multiple existing ones. If you think about securities clearing houses or any of those sorts of clearing houses you can have centralised or you can have a series of complementary ones. We have a series of complementary ones that have been built. If you think about the other functions of the New Zealand clearing house, they aren't necessarily intrinsic to the clearing function. They're supplemental functions and you might want to explore those or not. We don't have a view on - - -

MS CHESTER: Now, I know you took a note of it, I can still remember, but bait and switch, the protections that PWC suggested, Zak, did you have a view on those?

MR LINDEN: Honestly, I haven't read their submission.

MS CHESTER: I know, and that's an issue, but in principle, the four measures that they suggested, does it sound like it's heading in the right direction? You can give us feedback later more formally.

MR LINDEN: We'll have a closer look at it and I think it's important to – and for the Commission too to reflect upon what sorts of behaviours we've seen. The best interest duty, there are ways around it and it would appear as if at the moment ASIC is concerned that one very large financial institution, which is in the Federal Court at the moment, has potentially sidestepped best interest duty when recommending product consolidation. There's some limitations in respect to the FOFA regime and superannuation.

The other thing is, of course, which would be, we think, probably integral to the way in which for-profit institutions might look at the opportunities in obtaining a default pool is cross-sell opportunities for non-superannuation financial products which are potentially quite lucrative for them. Credit cards is an example of that. I can imagine that when you're thinking about - - -

MS CHESTER: The protections I mentioned before would get to that sort of stuff as well.

MR LINDEN: Yes. So when thinking – and these are the things which the Commission perhaps needs to be alive to in thinking about – as I said before, in thinking about these models and thinking about what incentives there are for the various providers and what risks flow from that and then thinking about how that flows through to the design that you're looking at.

MS CHESTER: I'm hoping we sort of tried to do that in the draft report. But if there's things that we've missed and the protections that we've suggested, plus others, don't get us there, please let us know.

MR MAY: The underscoring comment there is – and it is apparent in the cross-country data – for-profit providers are extremely creative and capable in undertaking regulatory arbitrage. It's just a fact. That's why we tried to make the comment around thinking about superannuation in an evolutionary context, that you don't set the rules of the game once. The rules of the game can be laid down. As soon as you hand your final report out it'll be dealt with, pressure will be put on how actually we get people into the real world. From then on, it'll be under constant arbitrage. The question, what are the parties and what's the power resources, if you will, in that ongoing ecology that you want?

MR HARRIS: We're going to run out of time, but one other – you have – I don't want to put words in your mouth, but you don't like clearing houses, you think they're going to be wasteful, you think our version of a clearing house is going to be wasteful.

MR MAY: I didn't mean to say that, Chairman.

MR HARRIS: No, I was thinking more of your submissions kind of information.

MR MAY: It's more that there is an existing – clearing houses are very valuable.

MR HARRIS: But the idea of using the ATO – I mean, in a sense the functionality is there. We may differ in our levels of knowledge of SuperStream but I had a little bit of involvement with SuperStream myself. It seems to me the functionality is potentially there. It's a question of allocating the responsibility and ensuring the staff to be able to follow it up. I'm quite interested in the idea because it does somewhat appeal. One of the things you can see around the world is the efficiency of this kind of – this level of the back office exchange does seem to be a pretty readily apparent efficiency (indistinct) but just efficiency.

MR LINDEN: We can look more closely at this, but the point we make is that, in effect, through SuperStream there is a clearing house that's been created through the SuperStream framework and various payment gateways which addressed – and I am aware of the fact that (indistinct) very early in the piece and pre-Cooper pushed this idea. Obviously the SuperStream architecture means within the payroll software systems that employers are using it aggregates payments which might fall to obviously multiple employees, potentially cross-multiple funds, and enables those payments to flow out into the system with minimum administrative burden on the part of employers.

MR HARRIS: I was just thinking the basic simplicity of saying, "Every time you submit your tax file number, your super fund comes up within the SuperStream system." This can happen, we can actually link the two systems and do this. You send the query back if another fund is nominated. But the query is – and this goes to your auto-consolidation point. I'm really trying to – because we are interested in the proliferation. It seems to be broadly accepted that it is a problem even though it is attempting to be addressed.

One way to address it is upfront, don't have any more account proliferation under the default system, just have a first-time arrangement. In your alternative preferences, we can deal with that by better efficiency over time in drawing out the proliferations occurring. I was just thinking if that was one of the propositions, I'm just trying to extend it into saying well, who would do that then? I'm assuming it would be the ATO.

MR LINDEN: I think probably you'll need to consider very carefully the existing SuperStream architecture. I'm aware of the fact that with the recent superannuation changes, new member attribute system, which means that, in effect, there'll be real-time information exchange between funds and the ATO about accounts and the ATO will be, in effect, getting a pipeline through the SuperStream system as well so they can see what payments are flowing through the system as well. I think the important thing is for the ATO to have the information rather than necessarily be the hub of having to deal with or process payments which come through the system for employers and then out to funds. I think the key thing is they have the data.

I think many of the things which you envisage or might be available through a central clearing house through the ATO are, in effect, already there. I think probably what we're concerned about is there's been significant cost already associated with establishing SuperStream that that's torn up and start again with some alternative arrangement which does very much the same things.

MR HARRIS: But you would have to accept cost – if you're going to say, "We're going to address proliferation and our position is through auto-consolidation," then you're going to have to accept that cost is part of auto-consolidation versus our version currently in the draft report which is no, make default in future just a once-only event.

MR MAY: I think that there's costs - - -

MR HARRIS: There's no cost to that.

MR MAY: There is and it is the cost that we touched on in a couple of other areas. It goes to what happens if you no longer a high-quality default fund and what happens – so there's two issues that arise from that. We noted one. If you lose your status as a default fund under the proposals, my recollection is you can change the terms and conditions on those default members and they're not moved into the higher-performing future default funds. That's one of the weaknesses of sticking in that fund forever.

The proposal we had means that if there's a refreshing of who those default funds are and you move to a new employment arrangement, you get an account in one of those high-performing funds and your existing members transfer over, unless you choose otherwise.

MS CHESTER: Your concern is – and maybe it's something that's not clear in our draft report – that if you're no longer top of pops but you stay still on the second longer list, you think once they're not top of the pops then they will dull down the benefits offered to members because they no longer have that status. Is that your concern, Zak?

MR MAY: My recollection from the draft report was that once you're no longer a default provider the requirements to stick to certain terms and conditions no longer hold. I can be wrong about that, but that's my recollection.

MR HARRIS: It's a useful point. I think the answer is we haven't answered that.

MS CHESTER: I think we have but maybe not through a model.

MR HARRIS: We have an information provision around when you fall off the list. We certainly have that. But you're going beyond that and you're saying, "And a year later, what happens?" It's a worthwhile point to make. Each of the models would need to think through "and what happens?" Anyway.

MR LINDEN: Can I just make a quick point about account consolidation? I detect that you might have misinterpreted what the proposal we put forward was. We're not suggesting that the form of account consolidation we're proposing is something which happens when people change jobs. Yes, there would be that process – that's the alternate process – to setting up a single default at the start of your working life and working through. We're talking about existing multiple accounts and active accounts and a process. Ultimately it would need to be driven by the ATO which would be to consolidate inactive accounts into one - - -

MR HARRIS: We're just talking about inactive accounts, not – we're talking about all of the accounts. We're talking about everything. You're talking about inactive accounts only in auto-consolidation.

MR LINDEN: Well, unless people are making contributions in the course of a 12-month period to multiple accounts, then it would pick up the vast majority of multiple accounts within the system which the proposal that the Commission has put forward wouldn't.

MS CHESTER: But in your default model, your preferred default model, you have a forward auto-consolidation, when you move to a new - - -

MR MAY: We propose both. If it's inactive, we should automatically rationalise existing – so the existing accounts and there's proliferation. There's existing multiple accounts, we can rationalise them if they're inactive after a year. For going forward to deal with proliferation, every time you move jobs your existing benefits transfer into a single account, so you wind up with only one.

MS CHESTER: I've just got one more quick question. Mergers. I had a few questions here, but I'll just ask one simple one. How does a member today know the reasons for a merger not proceeding and whether that was in their best interests?

MR MAY: There are disclosure obligations under the law and we could look at exactly what's required. We touch on this a little bit in our submission. Mergers is interesting.

MS CHESTER: Can we just stick to my simple question, because I'm conscious of time? Where would a member today – so say we've heard lots of war stories of mergers not proceeding that maybe should have proceeded for different reasons. And we'll probably try to move beyond anecdotes to evidence when we get to stage 3. But at the moment we tried to address this by saying, "Well, let's just have greater disclosure," because I couldn't work out where a default member today could find out the merger did not proceed and this was the reasons why, "Okay, that's in my interests."

MR MAY: First on the set of the facts around this, so the number of not-for-profit funds has declined since 2004 by over 91 per cent.

MS CHESTER: We've got the submission, keep - - -

MR MAY: Yes, but it is important because is there a problem here? If you look at the nature of this system and not-for-profit side rationalised by 91 per cent, on the retail side by 57 per cent, on average, not-for-profit fund are 8 billion, retail funds are 4 billion in today's market. So you have significant decline in the number of funds over time and you have a significant increase in the average scale of those funds. The question is, while there are anecdotes of failures of mergers, is this an area where there is a significant barrier? There are some around tax and equivalent rights decisions. But are they materially preventing consolidation? It's a difficult empirical question.

But I think if you look at the data industry is consolidating a great deal. The question around disclosure, we'll come back to you on that. We outlined in our submission some legal requirement that trustees have to provide information that are quite strong. But we'll look at the specifics and maybe see if we can find some examples of information.

MR LINDEN: Can I just quickly add – I wanted to provide - - -

MR HARRIS: You're going to be the last comment.

MR LINDEN: Okay. I just wanted to provide a little bit of data. I think there's obviously been some public debate around the issue of mergers and its role in system efficiency. I think if you do hard-headed empirical analysis as to whether or not small funds are the reason why there's inefficiency of the system, I don't think the data supports it. If you have a look at the 10-year rates of return and look at the bottom quartile, it is true that the majority of funds by number in the bottom quartile are small funds under 2 billion. However, they only account for 3 per cent of assets in the bottom quartile and 8 per cent of member accounts in the bottom quartile. There are some very large funds and institutions in the bottom quartile and we think that's where significant efficiency gains could be made in the system.

MR HARRIS: I think your reference to hard-headed analysis will – we understand that APRA has the best analysis that anybody can currently have, and we have access to that. But I'm interested in knowing is there something else that you have which is database for that purpose. We would like to see it, please. Anything that – even if you can – even it's just a – as I said before, quite a few advisers – or there are relatively few advisers in this industry. Sometimes they do put together data sets of a proprietary nature. You might have access to them. If you're happy to share them with us, we'd be very interested in them because otherwise we have to go and buy them and we're not - - -

MS CHESTER: Because the APRA data would lead us to believe that size does matter in the long-standing under-performing funds. That if you were to look for one factor – anyway, we can - - -

MR HARRIS: Not to dismiss what you said, which I think we're familiar with, we're just interested in knowing there may be more behind this. Every occasion that I can ask for access to information that we're otherwise not going to get - - -

MR LINDEN: Look, we'd be delighted to come back and have a deeper discussion with you about the data around performance, around the system structure. I think it's important to understand because it may well influence your thinking about models.

MR HARRIS: Thank you very much.

MS CHESTER: Who's the Tom Cruise fan at the ISA?

MR MAY: I think it's a universally held admiration.

MS CHESTER: It's just that the title of my submission was "Risky Business". I had a flashback straightaway.

MR HARRIS: Managed to miss me entirely. Thank you very much again for your time here today.

ADJOURNED **[11.09 am]**

RESUMED **[11.16 am]**

MR HARRIS: For the record, could you guys please identify yourselves?

MS DELAHUNTY: Yes, thank you, Chair. My name is Mary Delahunty, I'm the General Manager for Business Development and Policy for HESTA Superannuation Fund.

MR SAXTON: My name is Neil Saxton, I'm the Executive of Engagement Strategy at HESTA super fund.

MR HARRIS: Mary, do you have a few relatively succinct open comments to make?

MS DELAHUNTY: I do, indeed. Thank you, Chair. We appreciate the opportunity to be able to make not only those points but the submission as a whole and appreciate the opportunity to be able to continue the conversation. I'll take the submission as read. I understand you're running short of time. I thought there were, on reflection, some interesting points that you may find helpful in your further deliberations about HESTA and our role coming up to 30 years now as a safety net provider for members of the health and community services sector.

We've set out in our submission our typical member, but our typical member is someone that we keep at the front of our minds all the time. She's 43, she's very low balance, she has very broken work/life patterns. She has low engagement in her superannuation and she is incredibly unprepared for retirement. That is what we base both our product decision but also our whole fund around. We've always had a desire to reform as a fund and we've done so because we understand that our members face structural challenges that others don't. So we do enter these conversations with genuine intent to improve the system. We've done so for a long time. We did so in the 2012 design of the Fair Work Commission process that we believe should actually be the model that goes forward.

I've got a dual role at HESTA and this is something that I think is in addition to the submission which the Commission might find interesting. I'm responsible for policy responses which is, in general, an incredible honour because you do get to work on reforming the system. But my other role is in business development. That is for the growth of the fund and the fund at HESTA has grown organically since inception.

Now, that means that we don't sort of sit back and hope every day that a new member comes through the door, but we compete in tender situations quite often. I have on the go at the moment probably four live competitive races for safety net provision at an employer level in the health and community services space. I note that both in the first paper and in the draft report there's a seemingly – perhaps a lack of understanding as to how those competitive processes actually play out from the Commission's point of view in that there seems to be a continual conversation or commentary about the lack of competition in the sector. I can certainly assure you that a large part of my role is taken up with competition in the sector and so that's, in fact, not correct.

Like most of our funds of our genesis, members have overwhelmingly not chosen us, employers have chosen us for their members, for their disengaged members, and they do so with the help of industrial parties quite a lot because, as the Commission correctly points out, we're talking about members that are not actively making choices. So someone needs to stand in on their behalf. We believe that firmly to be the role of both the employer and the industrial parties to achieve a good result. They look at our performance, they look at our fees, they look at our insurance.

I note that the insurance is beyond the terms of reference for this draft, but it's sort of incomprehensible that it is beyond the terms of reference given it's a mandated requirement in the default offering and it's done so fairly much on a sector-by-sector basis, which differentiates the product and it makes it unique to, in our sense, the health and community services sector. I note we've got friends from Cbus here and in their world it makes their insurance unique to their sector as well. And it's why we've come from where we've come from.

When a member is defaulted into HESTA their retirement funds are directed to the corporal product. This corporal product obviously has a MySuper licence but it's 30 years old as well. So for a lot of industry funds when MySuper came about we could simply licence our existing investment products. It's the most appropriate place not only for default members to be but for most of us to be. It is our most diversified option and in that diversification it does have exposure to infrastructure assets, along with equities and some of the more usual exposures that you would see, but it has exposure to infrastructure and it has exposure to property, and it takes a very long-term investment view.

This financial year, in addition to – I guess I'm presenting information in addition to the submission, but I wanted to tell the Commission about some of our education concepts. Now, this financial year we will see around 70,000 of those members, whether they've been defaulted in or actively chosen in or been defaulted in and since become quite happy with where they are – so an engaged member – to educate them and to lift their ability to make good decisions about their retirement.

Now, this adds to our operational cost but it is something that is a gap in the Australian marketplace, this understanding of the compulsory nature of superannuation, understanding of how you actually make good decisions to build your retirement. It sits under Neil’s area. We have an enormous team of member education managers who spend time in the workforce increasing people’s knowledge of superannuation. The Commission quite rightly pointed out that there’s policy intervention required to build an educated consumer base. At that moment that need is being met by funds to the detriment of our operational costs but it’s an obligation that we can’t leave behind.

So I would encourage policy intervention in that space. In the great spirit of being reformers, a compulsory situation or a compulsory marketplace like superannuation should have an informed consumer base. The concern that we have with many of the policy interventions that are proposed in the draft paper is that it seeks to lock in the apathy that currently we see as such a detriment to the system. I think that is inelegant policymaking and it’s not exactly where the attention should be focused.

The other thing that impacts our operational cost is enacting reform, participating in reform and enacting regulatory changes. Some of these are very necessary. Indeed, we want to continue to shape what is, in fact, a very young system. But it has a real cost. I note, as we did in the submission, that we participated with great intent in the last process that sought to better strengthen their safety net provisions in superannuation. That resulted in a compromised position but, no doubt, a good one where the Fair Work Commission would play a large role in deciding default mechanisms.

We participated in that. It was at enormous expense to the taxpayer. It was an expense to our members and yet it hasn’t even been enacted. So we find that to be a really disappointing waste not only of taxpayer funds but of member funds. We might differ from some of our industry counterparts in our belief on choice. We think that a mature superannuation system such as Australia’s, everyone should be able to choose their own superannuation fund. But we don’t believe that that is then – if everyone has choice, that then the safety net system isn’t necessary. We think that the two go hand in hand.

In a mature, sophisticated retirement system everyone should be able to choose their fund, but if they don’t, we need robust safety nets underneath them because they’re compelled to be a part of this marketplace. So we certainly welcome the change, the seemingly changing language from the first report from the Commission to this one where we're, I think, a little bit more accepting that there needs to be a framework for default funds, that there needs to be a quality filter across them and it's over and above the MySuper licence, but that we all want to aim for choice. A part of that, as I said before, is about an educated consumer base.

Personally, I've had the great fortune of being awarded a Churchill Fellowship in 2015 where I studied a number of international pension funds, specifically on their gender equity measures for women. That included the Chilean system. So I'm quite familiar with how that actually works. I think it uses incredibly blunt policy instruments to achieve – well, it hasn't really achieved very much at the moment – but to seek to achieve some of the reform that the Commission has set out as well. So I'm happy to talk further on that.

We still think improvements could be made in the safety net area in the quality filter even though we completely endorse the Fair Work Commission process and we endorse that it remains an industrial matter. We think that those improvements should really look at whether or not, philosophically, on a principles-based decision, funds or businesses should be able to profit from inert money. We would certainly encourage the Commission in the stage 3 process to turn your mind to whether or not that is an appropriate outcome of a sophisticated mature system of whether profiteering or value cash up from members who have never made a decision is something that, as policymakers, we want to entrench.

We don't support any of the proposed models in the draft report in their entirety. There's a couple that almost replicate, with some notable exceptions, the Fair Work Commission process. But I'll come back to that process because it was carved from compromise by industry participants who genuinely believe it should be given a chance to run. Even if it's not given a chance to run, it should at least have been tested in this stage. So we welcome any discussion on that.

MR HARRIS: Thank you very much. Your most controversial point is your penultimate point, I think, you're really strongly hinting, perhaps you're explicitly stating, that you think at some later stage in this superannuation inquiry process we should consider whether any for-profit entity should be capable of offering a default fund to members, which is quite a substantial change to the existing system. Your view in that case, if I'm hearing correctly, is any profit incentive is inconsistent with members' interests. You've limited that though to default members. So your view is if you choose to go to a for-profit fund, that's your own lookout. But anybody who makes no decision should not have any chance of using a for-profit fund as a supplier.

MS DELAHUNTY: That's right.

MR HARRIS: It's worth noting. I took it from the submission that you were hinting at that, but you're pretty explicit now that's your – it's not so much for today's exercise, not in our view the way the terms of reference operate, but it will come up, therefore, in stage 3.

MS DELAHUNTY: That's right. To expand on that a little bit, having had the great benefit of seeing some of the other systems internationally and although their architecture might differ from Australia's, what is common is that we are actually a leading, obviously, provider of retirement benefits in the world. Now, we get the chance to rethink it, not to take some of the bits from the other parts of the world. We get the chance to actually design it ourselves. If we lift from the bottom, as we say, where we educate a consumer base, where we have consumers who are more able to choose because they're more informed, but yet we still have an element of compulsion and a need for a safety net, do we really imagine that it's okay for people to be profiting from those unengaged members, from people who have never made a choice but yet are compelled to buy into a product? Is it really okay in a world-leading system that we say you can come on in and make profit from those members?

MR HARRIS: Would you have seen the IR system, if it were in operation, as having enforced this particular proposition?

MS DELAHUNTY: The Fair Work Commission system currently? No, I don't imagine so. The filters that are over and above the MySuper licence at the moment don't have that particular element to them. But on that, if that Fair Work Commission system had have been allowed to run when it was legislated we would be coming up to now the fourth year next year. I would imagine policymakers and bodies such as yourselves would be ready to assess that and we would be having conversations about building on a system that was already legislated and improving it instead of throwing it out the window and starting again.

In those conversations about building on something and improving it I no doubt would be having a conversation about whether or not, as a country, we think it's okay that people have made profits out of members who have never made a choice without there being any policy intervention in the education of the consumer base.

MR HARRIS: I just wanted to clarify since you made it in your sub and in your remarks.

MS CHESTER: That's good. I'm going to reverse all my questions now and go to the simple one last. Mary, thanks for HESTA submission and for your involvement and participation, and Debbie's as well, along the way. It was neat to see on page 9 of your sub that you liked three parts of model 1 and model 2. You like the short list, you like the MySuper on steroids, which I think you more eloquently called it an elevated MySuper, and you like the independent body with oversight. I guess model 2 is probably the closest to our current arrangements which we call assisted employer choice. Your key sort of deal breaker issue being only a not-for-profit could have access to the default segment, if our model 2, assisted employer choice, was just not-for-profits with the short list elevated MySuper independent body with oversight, would model 2 then be the kind of model that you'd be comfortable with?

MS DELAHUNTY: Model 2 has more concerns than just what we would think would be an additional reform to the system in that people shouldn't profit from inert money.

MS CHESTER: I'm modifying model 2 for you by saying - - -

MS DELAHUNTY: Yes, but I'm going to request that you modify it even further, because one of the other points that we made on model 2, which we don't support, is that independent body at the moment – and I should say that model 2 probably gets the bulk of our support because it most closely replicates what has already been legislated and yet not enacted, except for the notable exception – and it's a massive exception – that the independent body is more closely aligned to the political system than it is to the industrial system. It seems to me to be a contrary view held in the paper that we want more independence and more transparency and for superannuation to stand on its own and yet one of the most important elements is that we move it closer by having ministerial oversight and therefore appointments and therefore removals of people who are assessing and encapsulating that quality filter parameters. It's a big cross against that model 2 for that particular reason.

MS CHESTER: Model 2 with only not-for-profit and with the FWC being the body.

MS DELAHUNTY: To be clear, the model that we support is the current Fair Work Commission model. If that was to be improved, we believe that people shouldn't be able to profit from inert money.

MS CHESTER: I guess what I'm suggesting is – because we're looking down the track to stage 3 – that model 2, with your tweaks, could be interpreted as an improvement of the current arrangements.

MS DELAHUNTY: Model 2 with the modifications that I've just said – no, sorry, model 2, if the independent body was held in the industrial system and has oversight from the Fair Work Commission, would actually be the current legislated process. It's just that it would have come with an enormous waste of time before it.

MS CHESTER: But you're still agreeing short list and elevated MySuper, which is not in the current legislated process.

MS DELAHUNTY: Well, I believe it is. We've got a MySuper licence in the current legislated process. There's a filter that goes on top of that. We're accepting that as the language now. But there's additional criteria that goes on top of that. Then there's a submission to a list. So there's the long list to sit on the award. Then in order to do that there's also a body that's appointed by the Fair Work Commission which, for lack of appointment, we would all be three years down the track in that insists on the - - -

MR HARRIS: Can I just clarify that - - -

MS CHESTER: Yes, because I need to clarify now too.

MR HARRIS: I think the two of you agree on something I don't think you actually intended to. Model 2, were it implemented, is generic. It's not award-based.

MS DELAHUNTY: Yes, that's right.

MR HARRIS: I don't think you agree with that either.

MS DELAHUNTY: No. What I'm saying that it belongs in the industrial system is - - -

MR HARRIS: Let's clarify. You're not agreeing to any part of model 2, really, because you want the other system.

MS DELAHUNTY: The name is nice.

MS CHESTER: Even though you say on page 9 you agree with the short list, you agree with the elevated MySuper and the independent body – but we can agree to disagree on who that might and we don't even have a view on who it should be yet on principles – you actually don't mean the short list that we're suggesting. You don't actually mean our version of elevated MySuper. I think other people might have misinterpreted your reading submission and not just myself, but anyway, that's all good; good to know.

Coming then to the principles, because we kind of like to go to principles before we decide who the body should be, we set out some principles in box 2. Did you have an issue with any of the principles?

MS DELAHUNTY: I'll go through it, if that's okay.

MS CHESTER: Yes. I've got it here, if it's helpful. Because in the submission you go straight to FWC but it would be helpful for us to know what HESTA's view is on the principles.

MS DELAHUNTY: The principles look very familiar from when we decided them in the current process. I think the principles, as in the dot points relevant to the composition and conduct of the selection body, are – we're okay with those.

MS CHESTER: How does the FWC meet the last principle, the first part of it?

MS DELAHUNTY: How do they meet being accountable for their decisions?

MS CHESTER: Yes. Who are they accountable to?

MS DELAHUNTY: The people who have standing at the Fair Work Commission, the rest of Australia. Well, I would see that the Fair Work Commission is an independent umpire that decides industrial matters every day. I mean, their accountability is to the country as a whole.

MR HARRIS: They're appointed, aren't they - - -

MS DELAHUNTY: They are.

MR HARRIS: - - - effectively for life as judges and able to – now, your panels, I know, so we can all go into incremental detail of it, but I'm simply saying the accountability that you've stated, from my knowledge of the Fair Work Commission system from our workplace relations inquiry, would say you can have one or the other. I can be utterly independent and therefore my decision can't be second-guessed other than on legal grounds or I'm accountable to somebody. You're not really accountable; you're independent. That's what the case is with the Fair Work Commission. They are utterly independent in their decision.

Presumably once the panel, if it were in operation, makes a decision, unless it's reviewed internally by – I don't quite know whom or who – that's it, baby, and so it's – the accountability is different to the accountability that a government itself might face where if it did, for example, as, I think some people have alluded to, appointed a partisan panel to come up with a horrible decision that was inconsistent with a criteria, it will be accountable at the ballot box every three years and presumably that would matter. We have an accountability definition perhaps is a little different from your own. I think you're really saying independence.

MS DELAHUNTY: Perhaps it is a little different, but I guess I have a little bit more faith that they would meet the accountability criteria and a lot less faith that a ministerial-appointed process would meet perhaps an obligation to act in the best interest of fund members. I think that there are balances to be struck within the priorities here and I genuinely have faith in the Fair Work Commission process and that accountabilities are understood, required and are broad.

MR HARRIS: Could the panel members appointed to the Fair Work Commission process be equally partisan? And who appoints them?

MS DELAHUNTY: Potentially.

MR HARRIS: Who appoints them?

MS DELAHUNTY: There was to be an appointment by government.

MR HARRIS: Ministerial, you see. It's like we clarified, but I don't think you were here, with the ACTU earlier. Really the position on partisan appointments says you can't have any powers anywhere. If you're worried about partisanship it's always a relevant consideration and you can't, therefore, have a mechanism that says, "Let's bring in some expert and then put them in a position as decision-maker because in the end they could be accused of being partisan," i.e. my expertise makes me partisan. Therefore, you can have inexpert members of panels but then you'd say well, they could be utterly incompetent and get decisions badly wrong.

MS DELAHUNTY: Sorry to interrupt you, Chair. I think there's a process that goes beyond just the appointment of the panel when it sits in the industrial relations system that gives it a little bit more of a robust nature to protect the best interests of members. That is, that industrial parties and employer groups still get to have standing at the Fair Work Commission, still get to argue the case. It's, as I see it, a little bit beyond an arbitrary decision from a bunch of people in a room that were appointed by a minister. I would wonder too, if we're sort of talking about apples and apples in the appointment of a selection panel, why on earth it hasn't been appointed.

MR HARRIS: They'll both be very transparent, won't they?

MS DELAHUNTY: I would imagine so.

MR HARRIS: It's very unlikely you would not know who these people are and therefore the accusation of partisanship is immediately on the table, isn't it?

MS DELAHUNTY: But I think that comes back to your original point. There's transparency as in we know what you're doing and then there's accountability. I think that the Fair Work Commission almost entrenches accountability through its processes.

MR HARRIS: Anyway, we have, as you know, in phase 2 tried very hard not to play in the space. It's just that since you came up with such a relatively radical proposition it was - - -

MS CHESTER: You took it there, Mary.

MR HARRIS: You really did, and I can't sit there and ignore it and then be potentially accused of saying - - -

MS DELAHUNTY: Well, I might actually say that you took us there by your reference to the Chilean system which doesn't allow for for-profit or insurance funds to actually participate in the tender process.

MS CHESTER: Our terms of reference took us to the Chilean system. Mary, in your other opening remarks you sort of describe a system where competition is alive and well and you're happy to compete. Indeed, you have to roll up your sleeves and you're competing on four tenders at the moment. Why is it you think competitions are right or wrong and you're happy to compete in the super system but you're not happy for competition for access to the default market?

MS DELAHUNTY: This is for access to the default market. Just to clarify, because I might not have made myself clear at the start, but the competition that exists at the moment, which we made reference to in our earlier submission as well, it's just not as – well, it exists for default business, let's put it that way. It's just not systematic and we think that there is some improvements to be made that would make it a little bit more systematic and help employers understand how to actually impart that system on a tender process. There is competition at the moment. We are happy for there to be competition. The transparency of competition means that there can't be any sort of third line forcing elements that might go on with some people who have vertically integrated business models and there's – we've made reference to that in the submission as well. So I don't need to go into it in any detail.

But to answer your question, I'm not saying that there shouldn't be competition if we are to propose a different model or to propose an improvement on the current model. I'm not saying that there shouldn't be competition. I'm saying that competition should be restricted to businesses who don't seek to make a profit out of people who have never been engaged.

MR HARRIS: I wanted to ask about the greatest risk that occurs to a member. A lot of the time has been spent by many funds competing against other funds. In other words, it's a fund-to-fund comparison. We spent more time mentally trying to consider members – and your submission starts out with a described average member. So I think we're on common ground about members. The nature of the default system and the reason we went to our zero base, that there is no default system, what does that look like, we went to that because it tells you why you would have a default system. In other words, we don't say today's system is the best system. We say, instead, once upon a time the system was designed for default. The question is today if you didn't have it, what would be the risks?

So we go to this primary question of, what are the risks to members? It has been stated in some submissions to us that the greatest risk to a member is being a default member, therefore non-engaged, therefore not even, as it were, knowing what is happening to their money is to end up in a poorly-performing fund. That's the greatest risk. Now, this morning we've asked that question and we've got some differing answers. So we'd like to know whether you think that's the case as well; the greatest risk to a member is to get stuck in a poorly-performing fund.

MS DELAHUNTY: I had the benefit of sitting over there whilst you asked that the last time, so I did turn my mind to that. I think that's right, a poorly-performing fund – but it's a pretty subjective measure because it's not just on investment performance, it's on your ability to then engage with them. But I think the Commission has identified something that is a risk to members and to the system as a whole, which is not only just to be defaulted into a poorly-performing fund but to be defaulted there six times throughout your life and carry all of those accounts into retirement without ever having made an active choice to consolidate or by the time that you make an active choice to consolidate it's a little too late to reap the benefits of it.

I think it's twofold. If you think, as I think you correctly are, from the members' point of view what is – for our nurse, she starts off with HESTA. We're not usually the first fund. So if she defaults into HESTA she may have some other ones, which is why we take our obligation on education very seriously. If she starts with us when she's 23 and she carries four other funds until we finally get her engaged at 55, the greatest risk to her is that she's paid too many fees for things that she's never engaged in and that that impacts her ability to retire with any sort of level of dignity.

There's a little bit about the default system in there, there's a lot about an educated consumer base as the greatest risk to this system as a whole to our typical member, and there is the risk of poor performance on any or all of those funds, including the one that she chooses.

MR HARRIS: That's right, and the question is, how then do you get this information into people's hands about what is a poorly-performing fund? Because if you don't have a good mental benchmark, then a couple percent might still look sort of okay without realising that you're in the lowest quartile. The answer potentially can be well, of course, there's a lot of information out there. And we've talked about it ourselves and there may be other mechanisms by which we can use existing institutions to improve information. You've talked about the fact that you try and educate members on these things. But we've still got a very, very substantial membership base that is utterly disengaged.

MS DELAHUNTY: Yes.

MR HARRIS: Our view is one that says what can structure do to potentially address that?

MS DELAHUNTY: I think that that's really the crux of the issue here, because there's structure that any of the models purport here locks in that disengagement, in my opinion, in the fund's opinion. One of the benefits of being a sector-based fund, as HESTA is, is that – I heard that you were somewhat dismissive earlier about beyond – so beyond engagement, what is it that you can provide to members? Well, beyond engagement is sort of another story altogether. Engagement is incredibly important and being a sector-based fund, HESTA, Cbus, we understand how to get into a member's workplace and talk to them about money at the time when they are thinking about money, which is when they are at work. We also understand that we have a number of shift workers. So our communication not only styles but methods differ, depending on our sector.

That's the ability that a sector-based fund. The fact that many of the models are seeking to not only entrench the apathy but also break disconnect that sector responsibility and the fund is, I think, a retrograde step in that respect.

MR HARRIS: I'm not sure we'd accept your statement about intending to entrench apathy at all. The system itself has had 25 years and it hasn't really varied this. So I don't think you could say our new hypothetical models are designed to do anything more than what you would appear to have achieved over a long period already with the current system, which is a substantially disengaged membership which is at deep risk, as you, I think, have agreed with me, of being stuck in a poorly-performing fund if they're in the wrong place at the wrong time. Therefore, the current question is, from a member's perspective, what more can we do about that from a structural perspective?

We did get on in another part of the discussion, and you probably were present for that too then, that says even if we – and there are differing views, obviously, on each of the individual models. But we've also gone to this first time one-time only default option as being a way of cutting down proliferation. It can be an incentive itself to have a view but it may not be. Can I get a perspective from you on that?

MS DELAHUNTY: That's where I was referring to before that we see that as an entrenchment of apathy. A one-time only default when you enter the workforce does not either then encourage you to get engaged in your superannuation and make good decisions, whether or not that decision is to stay exactly where you are or to make sure that your investment options are right or to make sure that you know that if you just popped $5 more in. In answer to your question, our response to that is that we believe that to be policy intervention in exactly the wrong way.

MR HARRIS: You said earlier that you're not usually the first employer in your industry. Under our model a nurse would turn up possibly having done a part-time job and would be in a different fund. You're very active in the workplace. You're telling me we're entrenching apathy and yet your advocacy is going to be the workplace join us. I'm afraid I still don't see how you can come to that conclusion.

MS DELAHUNTY: For a nurse it might not be the first fund. For a childcare worker it's more than likely to be the first fund. For someone entering the aged care workforce we might be the first fund. I was referring to our typical member earlier for which we may not be the first fund. We're engaged in a number of sectors. The view that we're taking towards the one default for life is fund agnostic in that it's bad policy to say, "Look, we understand we've got a disengaged consumer base. Nonetheless, set that aside, let's not do anything to actually increase the engagement and let's just lock that down."

MR HARRIS: Wouldn't you be competing harder if you weren't the first fund? Would you, as an existing entity with a substantial education option in your own hands, wouldn't you actually be competing harder in those circumstances to get those members because they were one time only? In other words, to convince them to come to your product because, as you've said in your submission, were relevant to you and your workplace, we've got a better designed, which is another interesting angle, but you've got a better designed investment option, apparently, relevant to this particular workplace. Why wouldn't you be competing harder?

MS DELAHUNTY: Competing under these models to be the one default fund for life, is that your question?

MR HARRIS: No, I'm simply saying let's just take the first-time only option in future for default. Let's just hypothesise that. Your members turn up potentially having the first time only – they had a part-time job. They're somewhere in a different fund. Why won't you be competing harder? You've said we're entrenching apathy. I'm querying it. I can actually only see you competing that harder to get that member to understand your benefits rather than to simply go, "It's all too late now," and we'll do nothing.

MS DELAHUNTY: I think in my mind they're two separate issues. We do compete for members right now. We either compete at the employer level or we compete member directly and, as I've said, we've done so successfully because we've grown organically year on year. So we understand our competitive set. We understand how to compete. Setting that aside, we'll continue to compete very hard for our members; we do so already. Once we've got them, we continue to educate them. But setting that aside, they're not divergent views to then believe that it's bad policy to just have one default for life.

Now, whether that's the HESTA default or someone else, the model to get to that one default for life is a race to the bottom on fees. It doesn't encourage funds to then engage a membership. If the policymakers aren't encouraging engagement, why would the marketplace? If engagement falls any lower, then people are not making good decisions on their retirement. If they're not making good decisions, then it impacts the money they'll take into it.

MS CHESTER: Set aside the auction model for a moment, if the whole raison d'etre of our models is to get default members to the best-performing funds, then what's the problem with the one default model if you agreed earlier that the biggest risk was them defaulting into a poor-performing fund?

MS DELAHUNTY: I agreed earlier that the biggest risk to them was defaulting into a poor-performing fund but that performance is subjective and it's not always about the numbers, it's not always about the fees; it's also about how the fund engages. So there's that. You can't necessarily have an abstract concept of a one default for life and not understand how you would get to a situation like that. How you propose to get to a situation like that talks directly to locking in the apathy, locking in low fees, locking in investment choices that don't necessarily have a long-term time horizon. That's always going to have a detrimental effect on someone like our average member.

MR HARRIS: That's a commentary in practice, not on the option. It's a commentary on the fund that you imagine is going to be that very first fund locking in low fees, things like that. So you're actually extrapolating from a vision that you have of the particular lucky beneficiaries of being the first timer rather than the policy principle, I think. I still can't understand how, if you are an effective competitor now and you're facing with not having a default member fall into your lap because under the enterprise agreement that's your lucky win, I can't understand how, if you are an effective competitor now, you wouldn't compete the harder to get that member. I think it's sort of almost counterintuitive to imagine that you wouldn't, that you would just give up and go home.

That's why you did make some comments on competition and how strong it was in your opening statement in which you've asserted you don't understand – in your submissions you don't understand how our model would work for competition, and it's actually that. The more that you don't have something falling in your lap through the industrial relations system, the more that you have only two choices in life. One is to give up, the other is to compete the harder and convince the relevant member, now an employee in your particular sector-based field of operation, that you're a much better party for them to have. That, to our mind, encourages choice, encourages engagement, is worthwhile. I can't see this locking thing at all, given that choice does exist.

Now, I could see it if the enterprise agreement says, "There's only one fund for you, pal, and you must get in this one." I can see that we've actually exploited choice. But I can't see it other than in those circumstances.

MS DELAHUNTY: I might just correct the premise, if that's okay. I think it's important because the gentleman sitting beside me is my boss and if he thinks that things are just falling into my lap, then I probably don't deserve to be drawing a salary today. But it's not the case that where you might have a default arrangement that members just fall into your lap. My opening comments about competition was to inform the Commission that there is competition going on at different levels whereby nothing falls into your lap and employers and industrial parties take their responsibilities, so far as we've seen, pretty seriously.

We've also seen employers be the subject of some fairly inappropriate behaviour from people who seek to profit from members who don't make any choices. There's no such thing as a member falling in your lap. Some decisions have been made along the way. The Fair Work Commission process sought to make those decisions more relevant to sectors, more transparent and more systematic. The one default for life seeks to say, in my mind, "Okay, we've got a disengaged consumer base and there's nothing we can do about it. So we'll just put them in one fund."

You can't then say it doesn't matter how we get to that point because everyone is going to compete over here. It does matter how we get to that point because they're disengaged and someone's got to help them.

MS CHESTER: I might stray from traditional practice and we might hear from your 43-year-old female member. Her name is Michelle MacDonald, she's submission number 77, and I think she's a HESTA fund member by what she said in her submission to us. But I'm going to quote her because often we don't get to hear the voices of members at our public hearings.

> *After making a concerted effort to consolidate 10 super accounts (all default) into one super product of my own choice in 2011, I then proceeded to be employed in five jobs, two of which I was not able to choose my own super fund, due to a compulsory default fund in the Enterprise Agreements. One of those two I was not even permitted to roll over when I left that job and sector. That account has $8000 in it that I can't touch, and its returns simply fund its admin costs.*
>
> *Back in 2011, my aim was to take control of my super.*

So she's engaged.

> *As a woman working in the health and education sectors, this has been impossible – due to compulsory default accounts that I had no interest in joining but was given no choice.*

I don't say that to appear despondent, just so we can hear the voice of your member.

MS DELAHUNTY: It is interesting and, if it's okay, Deputy Chair, may I respond?

MR HARRIS: Sure.

MS DELAHUNTY: I haven't had the chance to read her submission. Isn't that nice to get an actual super fund member engaging in this? But one of the reasons that we support choice holus-bolus across the superannuation sector is because we do see in health and community services that members who work in a public sector are required to have a fund there. When we support choice HESTA had on it is going to mean that we will lose members, but it's better for them. Michelle, wasn't it, is quite right. Like it must be very, very frustrating. And we've seen that.

Now, there are still some closed systems in the public sector. That doesn't explain all of the proliferation of the multiple accounts, but it does go some way and it certainly explains a lot of them in the health and community services space because there's a lot of public sector workers in that space.

MR HARRIS: Can you ask your last question because we're off time.

MS CHESTER: I was just about to do that, Chair. The simple question I just want to put – and a yes or no answer, please – is do you think poor-performing funds, so poor performing over an extended period of time, should exit and high-performing new entrants should be allowed to provide default super?

MS DELAHUNTY: Yes.

MR HARRIS: Good job. Thank you very much. Thank you for having what I genuinely – a big attempt in the submission to answer the points that we made in a particular way. I hope to see you in phase 3 because you've got quite a specific notion to put forward then.

MS DELAHUNTY: Thank you.

MR HARRIS: I appreciate your time and effort.

MS DELAHUNTY: Thank you. Apologies from Jenny who's currently on a plane and she would have loved to have been here.

MR HARRIS: I think Karen knows her.

MS DELAHUNTY: Yes.

MS CHESTER: I've been on one too many panels already.

MR HARRIS: Thank you very much for your time. I think that says Grattan. Is that right? Jim has been waiting patiently here this morning and can answer all questions without us even asking them because - - -

MS CHESTER: We're going to ask Jim different ones though.

MR HARRIS: No, I'm not. For the record, please.

MR MINIFIE: For the record, my name is Jim Minifie. I'm the Productivity Growth Program Director at the Grattan Institute. Also for the record, strictly speaking, this is a submission in a personal capacity. Grattan doesn't make institutional representations.

MR HARRIS: I'm glad you've found a workaround.

MR MINIFIE: What I'm going to say – that's right – is based on, among other sources, on work that I've done at the Grattan Institute. I've really just got three areas of comments to make about what, to my mind, would be sensible for the Commission to focus on as it rounds out the draft. The first is that I think there's more work that could be done to provide more detail and flesh on the options and to begin a process or continue a process of assessing those options. The second is there are some extensions to those models that I think are worth considering, so essentially to look at some alternative models, at least to some level of detail. The third, could I echo what some of the other comments this morning have already touched on, is just to step back and to ensure that you've absorbed more deeply, I guess, the data about the root causes or the data that would lead to views about the root causes of performance differences between funds and between different systems.

Let me just make a few comments on each of those areas. First on rounding out the design and the assessment of the options. There are several areas where each of the models I think can be assessed potentially with reference to data at a deeper level than you've got to in the draft. The first is around upsell. There's already been some discussion this morning around that risk. Indeed, in the report you talk about upsell as well. To my mind, the question about upsell arises with respect to all the models, not just to the option and the tender, which if I recall correctly, was the context in which upsell was discussed in the draft.

I think we've all heard this morning the context in which it might be advantageous to a fund to seek to essentially use a low cost winning bid, if you like, in an option context or a low cost winning product on an advisory shortlist as an opportunity to seek a more profitable essentially product down the track and to sell up on the way. Now, the question is, how material an issue is that? I've proposed in the written notes that one thing you could look at to begin to try to calibrate that is to look at the experience of what happened to the accrued default amounts that were still in the system at the start of the MySuper transition period.

Now, we don't have full visibility into what's happened to those, and I suspect that the vast bulk of those did come into MySuper products. But I know from speaking to one fund that successful efforts were underway to essentially sell people into non-MySuper products. That's not strictly identical to getting people out of a MySuper product or a subsequent product but essentially they were looking to prevent people going into attractively priced MySuper products. You could look past the aggregates that APRA has reported to try to understand how that might have transpired.

I think the second area that all of the models need to pay really close attention to is that as you move to a more performance focused environment and therefore the metrics around performance become more important, gaining essentially competitive pressures leading funds to present their performance in an attractive light becomes more critical. It's already important in today's model. But as you move to a higher performance environment it's finding ways to report fees that make you look good becomes an area that funds are going to be forced competitively to spend more time thinking about. And I've set out – I won't go through them now – some of the ways in which funds can tend to do that.

Just a wrinkle around all of the models again is how do you think about performance fees? Those are a function of your asset performance. They might not be listed as part of your fees. If I move to a model with very low base but high performance, am I a high-fee fund or a low-fee fund? You've got to think through how those things might work, and that can affect the attractiveness when you're comparing an option or a tender of a purely fee-based tender, would tend to push you – to the extent to which performance fees are appropriate, that pushes you towards a multidimensional tender. It's worth thinking through. Then there are details around entry and exit fees and so forth, ensuring that funds aren't finding ways to look cheap on the relevant metrics.

My second comments around the rounding up the design and assessment of options is just to look explicitly at the likely cost to members of marketing efforts because there's a broader issue than just upsell. If you've got purely advisory shortlists for employer choice or employee choice, then it's clear that products that are not in that short list are going to try their hand at the market and they'll have a degree of success and costs will be incurred both by them and the funds on the shortlist. The full cost to the member, of course, is not just the marketing costs that are incurred by the funds, but also the (indistinct) performance to be members that are induced into lower quality products.

As an empirical exercise what I've suggested is it might be possible to learn from some of the systems which have got characteristics like full choice today and the 401K arrangements in the US could be a good example. What we've seen there over time is that while average fees have come down – and if you're on a large 401K plan today your average fees are quite attractive. But there's quite a significant tail, mostly populated by smaller plans, smaller employers, essentially – there's a closer link between those two things. While, as I understand it, there's no advisory shortlisting process in a 401K environment, many of the competitive attributes of that environment would be similar to what we would have if you went down the advisory route. That would be informative to you about how big the tail might be and that could provide you with a baseline to assess that model against others on a databased model.

Now, moving to the tenders and auctions, it strikes us – and we thought about this a lot in the context of our work in this area – that there's two stages of challenge – and you've picked this up in your draft as well. The first is, how do you design the initial selection phase; and the second is, what do you do after that with the funds that are winners? In your draft you've called that the performance monitoring phase and you've put forward a view that essentially says, "Well, if you did badly enough, then you'd sort of be removed," and presumably having relatively frequent additional rounds of the tender would mean that funds who wanted to stay on that list in order to be accessing future (indistinct) would be incented to provide to performance.

But as we've seen elsewhere in the super system, you've got this question about what happens to the orphans, if you like. You're a member of a former default product or a former winning product. It's kind of like what you would have if you had a member of a MySuper product that is no longer on the list. How do you provide incentives in a broad way for continuing efforts towards performance? It's a big challenge. I don't think there's a perfect way to do this. But one of the ways that was put forward by the Centre for Market Design in a brief piece that they did for the financial system inquiry is that rather than having just a performance monitoring phase for the winning group, they proposed having what they called a tournament. What they mean by that is that they have something like the New Zealand model where members are randomised into the shortlisted firms, but the probability of being randomised into a given fund would be a function of a measure of performance.

This is in a sense their view, the Centre for Market Design's view, about the two parts dovetailing together. These become quite technical issues, I think, figuring out, "Well, would this really work?" and what properties of that system. Recognising that, the Centre for Market Design proposed that significant additional work be done to flesh out, refine, evaluate, test, possibly in a desktop environment, that type of a model. I believe that it's appropriate to do that because this question of how you manage the ongoing performance incentives in a tender model is really key.

I don't think that your model has got zero incentives at all. For one thing, the funds are continuing to engage with their existing members outside of this kind of – the contest for new members. Then, as I've said, they've got the repeated tender that they'll seek to win. But an alternative where you've got essentially variable inflow could be worth examining. But it needs to be examined in quite some detail to develop confidence about how it would work. In my view, it's this phase, it's phase 2, where that kind of work ought to be done. If you leave it until phase 3 I think you want to very much be in assessment mode at that time with a clear view about the relative strengths and weaknesses of the models that you've assessed here in phase 2 so that you can sharply contrast and ultimately come to a position where policymakers can draw pretty clear inferences from your work. I'd strongly recommend doing more detailed work about the property of those systems.

Additional points. Thinking through the strategic asset allocation at the time of the tender or auction and afterwards becomes important. One of the attractive things about some kind of continuous tournament – and to the extent that other models also incent additional performance – is you want funds to retain discretion over their asset allocation and over their investor – their asset manager selection. So you want them to be free to respond to market movements and the whole set of very complicated developments in the world of what assets are listed and what assets are unlisted and what have you. You don't want to be more prescriptive about those things than you need to be. There's inherently a tension between being clear enough in the first phase that you can have a like-for-like comparison and giving freedom after the fact.

If you really believe that the unlisted is very important and if you believe that adjustments to strategic asset allocation ex-post are going to remain very important, which I think is in some degree an empirical question – I'm not convinced that's true. It could be true. Then you'll be tending more towards a tender in the first phase because you're going to have to look at these multiple dimensions include fees and past performance, and you'll be tending more to think about the ex-post tournament as potentially a mechanism that might be producing incentives.

Let me just step now to potentially some alternatives to the models you've put forward. The first would be, as you've requested, I've got a couple of comments on expanding the potential coverage outside of the first timer pool. I think that would be really sensible to look at that in great detail because - - -

MR HARRIS: But you're happy with the initial starting out point being first timer.

MR MINIFIE: No. You're talking about every year – in the first year you run this you'll get less than $1 billion of (indistinct). This is a system that's got over $500 billion in default. So it's going to take many, many years before you begin to have a material, if you like, "market share". Now, of course you're going to get more because some of the winning funds might be quite large and so their income and members will come across. But I think this just needs to be carefully thought through because the – you might find people sharpen their pencils quite hard to win significant new inflows.

MR HARRIS: Just to be sure then, Jim, as you go and describe this, because it's a curious concept to me and not one I necessarily intellectually can get my head around. You're going to explain that. But that says to me that you're in favour of proliferation at the moment because first timer pool is a response to proliferation. If you're not saying first timer, you're saying incumbent system - - -

MR MINIFIE: Yes.

MR HARRIS: But you've got a wrinkle to add to the incumbent system. Tell me that it's going to deal with proliferation.

MR MINIFIE: Today, I think the most recent figures for the number of new accounts created is about a bit over 2 million a year, 2.3 million, something like that. A fraction of those are new to the labour force, maybe a fifth, something on that order, maybe less. If you were to have a default process whereby people who switch jobs defaulted into one of the winning firms, shortlisted firms, give them full choice to retain their fund, if they prefer. Then you wouldn't have account proliferation. What you'd have at the time of switching jobs is that people would flip into this new winning product if they did nothing and if they exercised a choice to retain their existing account, they would retain that relationship. So you wouldn't have additional funds, but you'd have much, much larger inflows in the early years.

MS CHESTER: Jim, your primary concern – maybe you can just separate from account proliferation first, Peter. Your primary concern is the new entrant pool is not big enough – it doesn't answer the supermodel question: Will they get out of bed and compete for it? Is that your - - -

MR MINIFIE: Well, even if they do – so there is that question, and it's not clear to me that a major fund would find it optimal - - -

MS CHESTER: It will impact 400,000 members each year. That's the new job entrant, 400,000 each year. If those funds are some of the bigger funds – so they've got other default members – you could see within four to five years you're starting to get a large chunk of the default market in terms of how the models would trickle out to them.

MR MINIFIE: If it was about a fifth the size of the transition – and you obviously won't have any impact on people who are already in the workforce, with the exception of those who are with winning funds. It's a question of the coverage - - -

MS CHESTER: That's why I say, is it the supermodel question? Because you - - -

MR MINIFIE: No.

MS CHESTER: Sorry, if you want the trickle-on effect to be greatest in what the biggest default funds today – the high performing – to be winning the best in show because then we get to all of their default members.

MR MINIFIE: Yes, that's one way to achieve it. You could have a tiny thing, as long as you've got a big tail being dragged along. But the other way to do it just to increase the coverage by ensuring that people who are potentially in the market for a new super fund anyway because they're moving jobs have got a different default than the one they've got today.

MS CHESTER: You're going back to what was our issues paper position of you want the whole job churn and you won't use defaulting and it's just a job churn, you want them to be subject to the new model.

MR MINIFIE: Yes, I think you just need to evaluate the pros and cons. To my mind, there are significant pros of the bigger pool.

MS CHESTER: We can see the pros of the bigger pool. The biggest thing we're grappling with, in addition to account proliferation, is the system stability issues. Indeed, you touched on it with your remarks about what do you deal with those that aren't successful.

MR MINIFIE: Yes.

MS CHESTER: That's why we pull back from the job churn to the new job entrant but trying to make sure the models would have as big a ripple effect as possible, and it was to manage, effectively, the exit of the default funds that don't get the gig and they're already in an outflow territory. We're trading with a system stability.

MR MINIFIE: It's a trade-off. My sense is that you may find that large funds do not find it attractive to make a significant change to their business model in order to cut their fees sufficiently to win the tender for a small inflow - - -

MR HARRIS: If it were fee-based. But if it were performance-based, then your problem doesn't actually emerge. In other words, let's say fees were not a consideration, it was just performance. Let's be extreme. That's not actually the case. But if it were performance-based, then the fact that I've had very good performance the last four years makes me a guaranteed winner in this contest. So the fact that I've got 600,000 incumbent members that I'm still going to have to offer that promise too, hey, I've just offered it to them for the last four years. I'm a guaranteed winner here.

MR MINIFIE: Just can I say in passing with a really broad look at that performance on a risk-adjusted basis, you do find – I mean, you see it very strongly in one year, but you see at even five year that high performers in period T tend to be low performance in period T+1 because they are the risk takers.

MS CHESTER: I think we say five to 10 years. We want to get as close to 10 as we can.

MR HARRIS: And we do worry about that. Industry Super themselves made a point that's worth us following up too about what happens subsequent to it about that variation that does occur. We haven't worried about it. We have got some design work on it. We need to probably do a bit more.

MR MINIFIE: That's right. I won't belabour the point. But my sense is that that choice, to my mind, you haven't really proven yet that you've got the balance right. Not having carefully analysed it myself, my sense is that you may find you get very, very slow ramp-up and that small funds will tend to win. Let me just move along. The next one is how much attention do you need to give to today's default arrangements? My sense is thinking through very clearly and just ensuring that you're in a position in phase 3 to very quickly use the data that, I presume, is going to be in place, to make a call about whether today's arrangement made sufficient headway or not you just need to be very explicit about well, what are the criteria you're going to assess these new models against and is the analysis you've done in phase 2 going to neatly dovetail into all of the criteria that you set out in phase 1?

To my mind, it's not clear that that's the case. I'm not saying I think it's not the case, but to my mind, the final product - - -

MS CHESTER: We'll show you where it is in the report later.

MR MINIFIE: - - - would look very, very alone. Are you saying it's already in the draft?

MS CHESTER: We've addressed how we'll do it in stage 3 in the draft. Jim, I'm conscious of time. I've got a bunch of questions and I'm sure Peter has got a couple as well.

MR HARRIS: I've only got one really but it's two parts to it, but anyway, you go.

MR MINIFIE: Why don't we flip over?

MS CHESTER: We jump into questions? That'd be great. The issues around bait and switch or upselling, you might have heard before, we said that we were very mindful of that being a risk across all models, and we've had an information request. I guess what would be helpful is hearing back as to what you think we need to put in place. We had a couple of goes at it, but PWC has also had a probably better go at it than we did and they're focused on it. They've come up with four suggestions but two of them are key, and it would be good to get your thoughts back on those. They are that you would have explicit controls on inducements that are non-super products or super products that don't have member benefits, clear member benefits. Then your point earlier about reporting to APRA in movement of members from default to related-provider products.

The funds who win best in show, the default, would have to provide say quarterly or annual reporting to APRA on that sort of flow of movement. That way APRA would then step in and play the regulator roles to have a bit of a look as to whether that's inappropriate or not. Then they've got a couple of other – the vote for best interest and members' best interest obligation and all the rest of it. But those were the two key ones for me. It would be good to know whether you think they would help and if there's anything else that's needed around that concern that you raised as your number 1.

MR MINIFIE: Look, I brought it up first but I wouldn't say it was my top concern. I suspect actually that the sort of – my bigger concern about the first two models is it's difficult to incent sufficient fund consolidation. Obviously you've got some other initiatives that deal with that. Both of those proposals look sensible, the inducements and the reporting; they look sensible.

MS CHESTER: One thing you didn't mention in your opening remarks that you did in your submission that interested me was you felt we'd gone a little bit too far in paring back the default product. We sort of identify the five things that we thought were must-haves and good-to-haves. What do you think we've pared back that we shouldn't have pared back on?

MR MINIFIE: First, the bigger picture here is that to the extent that you've got a very, very pared back product you will tend to find that active people, active, more engaged members may leave that product. You'll find that the coverage of – let's assume that the investment performance is very good. You might find that the coverage of that product is going to be smaller than otherwise.

MS CHESTER: Someone chooses to then exercise choice.

MR MINIFIE: Per the discussion we've already had this morning, there are some paradoxical aspects to choice. Obviously choice is a good thing in its own right. Many people do better when they exercise choice. Not everybody does. That's one question. Then I heard one of your other submissions this morning. There are also potentially benefits from engagement and if you do create a product that is highly stripped down, then people won't understand potentially as much about their position versus their retirement goals and there are defined retirement goals, so forth. So I think there's just a question about whether in providing a highly, highly stripped down product you've got the right trade-offs.

MS CHESTER: I guess I wouldn't see it, and we didn't intend for it to be, a highly stripped back. We got what I think are kind of the poor manilas, the investment (indistinct) intra-fund advice, admin services and the intra-fund advise should help members understand the super system. They're informed about the performance of their investment product, the fees they're paying, the switching options and the process for exiting. Let us know what else is missing that we need to kind of add in there.

MR MINIFIE: I'll come back to you.

MS CHESTER: And we're not overly prescriptive about the investment, just said it's got to be good investment performance.

MR HARRIS: My primary question, Jim, is, how do you go about dealing then in your preferred vision of this – how do you go about dealing with what I think collectively this morning most people have agreed is the greater risk about being stuck in a poorly-performing fund as a default disengaged member? Most of the models - - -

MR MINIFIE: Do you mean in today's system how do we fix the problem? Because that is one of the big problems to the system.

MR HARRIS: No, I don't. Hopefully you're with us on this page because not too many people are. In this phase we went to zero and then moved up. So that told us, as we say, what a default system is really doing. So we have four models and a first-timer pool, all of which would create quite a lot of incentive in one form or another for the losers to do something. Today there is no such incentive for the least-performing funds, other than that APRA is meant to look over their shoulder.

Now, we've heard an argument that the Fair Work Commission might have a crack at that. I find it's still all uncertain how that might occur, but we'll certainly give that thought. We've heard various things, you've been sitting through most of it. I'm interested in sort of knowing what the Jim Minifie view is about how we deal with that, presuming you're going to accept, as I think you probably will, that is probably the biggest single risk. You've got people who are not engaged where we've mandatorily taken their money and we're putting it in the hands of another party. At the moment it's driven by a variety of factors as to which that party is, but it's definitionally not their decision. So the risk that they have is that they get stuck with a bad one. They don't even know that because, by definition, they're disengaged, i.e. they're default members, they're disengaged. What's your version of how to approach that?

MR MINIFIE: Just to be clear we're talking about the same thing, we're talking about somebody who enters the workforce say in 2020 who is defaulted into a fund that wins this process but turns out to be a - - -

MR HARRIS: No, I'm talking about today's system. I'm trying to work out whether you actually think that we're going to get positive shifts and incentives towards either winding up poorly-performing funds or increased member engagement or something else from one or more of the models and the first-timer pool. It's a judgment about what you thought when you read the overall draft report.

MR MINIFIE: It's very difficult to get a hundred per cent coverage for the reason that has been already in discussion this morning, which is that some smaller or otherwise poor-performing funds appear to be very reluctant to merge. Now, whether they're just not an attractive merger target for the other funds or there are other reasons why the funds may not wish to merge, it's very difficult to do more than what APRA has already said they're going to do. You're going to mandate that those funds be closed down, that would be the end result.

To my mind, the way to minimise that problem is actually very close to what you propose, which is you need to have several different complementary streams policy development, one of which is to ensure that there aren't as many of those people going forward. That's to ensure that new - - -

MR HARRIS: Exactly.

MR MINIFIE: The second one is to try to ensure that the back book is predominantly larger scale and so forth. So encourage consolidation and remove account – you're still going to have some high cost funds. Then the third area that will work for some of the people who have fallen out of those two cracks is about engagement. But we know engagement is pretty weak. Then beyond that, it's just about well, how aggressively do you mandate. Beyond that, I don't see any way to do it. So what we put forward in 2014 has actually got something in common with some of the improvements you put forward for the choice environment.

We said could you potentially an ATO process to ensure that people are presented with just the shortlist, the winning funds, some comparison between where they are today, and you get some level of uptick. But I think intrinsically if you're not going to mandate that people are moved you're always going to have a tail of people who are on very bad products, most of whom, of course, are actually outside of the default space.

MS CHESTER: On the legacy then, the rump, which is kind of I think the key issue we're now talking with, we read it in terms of people seem to be – well, we get different answers on this. Some people think there's no problems with mergers and some people think there are problems with mergers for the small underperforming funds. Those like us who think there might be a problem are frustrated with the current response is the regulator has a role with the scale test, which we still don't quite know how that's going to work, and then there's conversations with the regulator. And we know that they've certainly dolled that up recently.

As answer was let's get a bit more transparency around it. So we suggested more disclosure around merger discussions but then we've got people coming back to us saying that could result in unintended perverse effects and discourage those discussions from occurring. We've received one or two submissions which have helpfully suggested well, let's really up the enhanced role of APRA here where there would have to be real-time disclosure post-MOU to APRA on an outcome of merger due diligence and if it's not proceeding, why. The scale test be assessed for its effectiveness, although I'm not sure what we're assessing just yet. And greater guidance on managing conflicts of interest re selection of merged entity.

They've given some examples. For example, you don't decide on who the CO in the new board is going to be until after you've done all the due diligence from the perspective of members' best interests. We went disclosure but we knew that there could be some wrinkles around that, so we had an information request. People have come back saying let's really elevate the role of the regulator here. It would be good to get your thoughts of those two streams and which one we should continue our endeavour because you've suggested a couple of errors of our continuing professional endeavour.

MR MINIFIE: I would agree that the disclosure has got potentially some risk of unintended consequences. I would tend to go to just, for all of its imperfections, something like the aggressive application of scale test which, incidentally, would interact quite strongly with an effective process choking off inflows to weak performing funds. Now, that's going to be uncomfortable for the members of those funds for a period of time, until they merge, till they get to a better product. In a sense the policy decision has to be, do I want to have an environment where ultimately I don't have people in underperforming funds at the same rate as I do today? I suspect that the combination of quite aggressively choking off inflows to poor-performing funds, which, incidentally, would tend to push you very hard towards the job switcher pool, not just the new entrants pool, and an aggressive application to scale test may be as close to as good as you can get. I find it hard to imagine that disclosure would make a big difference because there's already quite a high degree of disclosure. Everybody knows their subscale. Everybody knows what their fees are.

MS CHESTER: Two quick questions and they're one-word answers. If you had to choose one of our models that we do more homework, as you've suggested, Jim, which model, 1, 2, 3 or 4?

MR MINIFIE: I'd go for the multidimensional tender. Is that 4 or 3?

MS CHESTER: Three, excellent. You know the simple question; what's your answer?

MR MINIFIE: The answer is no. Which version was the question?

MS CHESTER: Should low-performing funds exit and new - - -

MR MINIFIE: Yes, they should exit.

MS CHESTER: Thank you.

MR HARRIS: Thanks for your time, Jim, and your ongoing advice as well.

MS CHESTER: And that help on the roundtables and the workshops and everything too, Jim, much appreciated.

MR HARRIS: We're going to try, for anybody who's going to be an audience for this, to dial into New Zealand now and get Sam Stubbs and Peter Nielson on the phone.

MS CHESTER: Good afternoon. Is that Sam and Peter on the line?

MR STUBBS: Yes, this is Sam Stubbs.

MS CHESTER: Terrific. Welcome to our public hearings, Sam and Peter. This is Karen Chester. We met about six or eight weeks ago in New Zealand. I'm also joined by my Chairman, Peter Harris. You're sound surrounded in a room in sunny Melbourne with about 15 people listening in from the docks and a gentleman taking the transcript. So the main thing you need to know is that we're recording everything you say and there'll be a lovely transcript of record of it that you can show your grandchildren in future years. But to help the gentleman who's doing the recording, if you could just separately state your name and who you represent for voice recognition and then we can get underway?

MR STUBBS: My name is Sam Stubbs from Simplicity in New Zealand.

MS CHESTER: Is Peter with you?

MR STUBBS: No, it's just myself.

MS CHESTER: That makes it easier for voice recognition.

MR HARRIS: Thanks, Sam. It's Peter Harris here. Karen has heard and our little team that went over to see you a little while back and you've offered some intriguing comments to us and a short submission which has put those down on paper about the potential for running an online-only low fee style product which could offer a substantial potential competitive benefit to members in the default super space in Australia. We're particularly interested, I think, in some comment that you've made on the nature of the system that is offered by the Internal Revenue Service, I think, in New Zealand which assists you in running a clearing house operation. I'm just wondering if you could put a few comments down or make a few comments on that topic for us.

MR STUBBS: Sure. It would not be possible for us to run this business without the IRD here providing the services that they do. I can describe this hopefully very easily to you from a contextual point of view. What Simplicity does is we run the lowest fee scheme here and we have our business future proof now so that in approximately five years' time we'll be able to offer a full online superannuation scheme which is fully invested at a flat annual fee. We're targeting something in the region of between \$50 and \$100, which will be the maximum fee that anybody will pay no matter how large their balance was.

Now, one of the critical aspects to that is that if you think about the payments structure of our scheme the money that comes in and, most importantly, the money that comes in, to (indistinct) keep the money that goes out as well, that is done via a single relationship with our IRD. So they act as the collection agent for all of the contributions via salaries by (indistinct) relationship of every employers. So they do all of that point to point relationship with employees and we only have to deal with one institution. (Indistinct) we have an incredibly low cost, indeed efficient way, of receiving money. If we didn't have that we would have to establish individual relationships via (indistinct) or via employee contribution systems which would require us to have either very manual systems or very, very many different automated systems for handling money. That would make the economics of our business just impossible.

The other advantage I guess of using the IRD is that if there are any changes, a couple of modifications, you're only doing that with one party. From the employers' perspective, they like it as well because they don't have to establish a relationship with multiple superannuation providers. They only have to make one series of payments to the IRD on behalf of their employees. So from their point of view it's extremely simple as well. The one party that might be a bit unhappy about the extra workload here is the IRD. But I think you'll find that even though they would acknowledge that their (indistinct) facilitation of the payments makes for a much more efficient system. (Indistinct) had any dealing with the competition which greatly affects the efficiency but hopefully (indistinct).

MR HARRIS: Sam, the other thing I got but I can't remember from the notes whether it was from the discussions that the team had with you or whether it was with internal revenue themselves is a view that the SuperStream system that we have now set up here in Australia would be I won't say absolutely simple but would be relatively simple to adapt to the purpose that you have in mind for your model. Now, it may have been internal revenue said that to us. Anyway, do you have a view on that?

MR STUBBS: I don't have a specific view, but I will say that our model is – certainly under the current structure we would not consider offering our services in Australia. But if two things were possible, then we would be able to offer it (indistinct). First of all, there's some degree of mutual recognition of our products so that we would be able to do a reasonable amount of (indistinct) here and offer the product into Australia. But I think that's a super issue that provided there was a degree of mutual recognition (indistinct) amount of due diligence as if we were a new operator in Australia. By the time (indistinct) would have been an experienced operator here.

But I think the two things that are probably more relevant to your investigation now are we would have to be able to sign members up online. We provide a 100 per cent online service. That removes the need for us to (indistinct) physical distribution of the structure, either in the form of branches or sales agents or paying commission. So we have a direct relationship with our clients. There's a lot (indistinct) online and that requires members to sign up online without requiring a signature on a piece of paper where people have to show proof of identification and so on. Having the IRD as the agency it really facilitates (indistinct) play some part of assisting us in verifying people online, people that all have (indistinct) new IRD member. So they have an identifier. That would be the first thing. The second part will be that the IRD will (indistinct) would need to be a centralised collection agent for the information and for the payments. Now, my only concern about having anyone other than the IRD is that I would strongly prefer it not to be a privately owned organisation because in doing that you will effectively be handling a quasi-monopoly on payments. I cannot believe that the processing of that over time would be inflicted (indistinct) situation. (Indistinct) and know that we wouldn't ultimately – paying through the nose for what would be a government agent fee.

But I'm unfamiliar with the organisation you're talking about, unfamiliar with their workings and structures and so on. But my only concern would be that (indistinct) that it would work government-related entity that only controlled that.

MR HARRIS: That's fair enough.

MS CHESTER: I think, Sam, it's interesting - - -

MR STUBBS: If both of those things were in place we could really (indistinct) with those three things in place we could easily compete. With any one of those three (indistinct) difficult. It's nearly impossible.

MS CHESTER: Sam, I think it's the second one, the fact that you can do it all online, which is where we put the suggestion of the ATO potentially transitioning to this clearing house role akin to New Zealand in the future, we didn't articulate that akin to New Zealand means you also get the same regulations that allows you to do it online, because all of the super funds thought, "Well, this is just basically what Link and some others do for us at the moment and giving it to the ATO." It completely changes the admin cost structure if you can do it online. Do you have a sense of the order of magnitude of what it would mean to – what your fee structures would be, your 50 to a hundred bucks a year, in the absence of the New Zealand clearing house model? So you can't do it online but you might still be able to go to a provider that can do it for you.

MR STUBBS: (Indistinct) clearing house model via the IRD.

MS CHESTER: Yes.

MR STUBBS: It would be – gosh, I can't think that it would be many multiples.

MS CHESTER: That might be handy for us to get those metrics from you - - -

MR STUBBS: We would literally need to maintain relationships with thousands of parties. Even if you had multiple product (indistinct) suppliers doing that for you, still maintaining multiple relationships (indistinct) change management issues and so on. I would think that it would be in the order of – given that (indistinct) system in New Zealand – in theory we should be able to go to a fixed cost model. I would think that it would be, gosh, four or five times would be my best guess.

MS CHESTER: It would be great and very helpful for us, Sam - - -

MR STUBBS: Certainly with that we would be charging – sorry, one other comment. I don't think we'd ever be able to (indistinct) by going to a fixed cost model. We would always be charging (indistinct) under management under those circumstances. If that was the case, that would, by definition, for large balances be a much more expensive proposition.

MS CHESTER: It would be really helpful for us - - -

MR STUBBS: It would be something that (indistinct) from the industry, (indistinct) I don't think they would knock the efficiency of having a centralised payment agent because it really does move a lot of the reasons they otherwise have for charging the fees that they do. Even in New Zealand when you challenge them on this (indistinct) but that with the entering of competition by Simplicity coming in, they're eventually going to have to address that and things will come tumbling down.

MS CHESTER: Sam, on that last point, is that because you've basically stripped out most of your admin cost? So the lion share of the fees that you're paying that are really investment management fees. So you get greater transparency around that?

MR STUBBS: Yes, sure. (Indistinct) there's the fund management costs and, as we're well aware, there are a variety of options (indistinct). The second issue is the administration costs. By that we mean fund accounting, unit trust registry, those functions. Those costs in New Zealand are significantly lower than Australia because the administrator is liaising with the IRD. So they're building an API with the IRD for all of the key information they need to do, unit registry, money coming in, all those sorts of things. So it's not ourselves who (indistinct) in Australia. But the administrator doesn't have to have thousands of (indistinct) individual employers. So that's the second component of the cost. The first one we call funds management. The second one we call registry administration fund account. The third part of the cost is the funding of the business, the customer service, sales, marketing, branding, all those sorts of names.

If you think about the cost structure in New Zealand, because of 100 per cent online operations, we're able to do customer service, customer acquisition and so on far cheaper than anyone who has branches, commission sales or agents. You think about the second component, the administrator can do those functions far more efficiently because they're only dealing with one party, the IRD, for all of their members. So it's much more efficient. We have fixed price contracts in place which are extremely – well, they are based on a dollar per member basis and they get very low cost very quickly because (indistinct). The third part about the asset management is all in place via (indistinct).

MR HARRIS: If I can clarify – it's Peter Harris here again, Sam – because it's asserted, of course, that low fee based funds are also poor-performing funds. Can you give us a sense of – just a generic benchmark how well you rate in a performance sense and an investment performance sense?

MR STUBBS: We've only been operating seven and a half months. But I believe now (indistinct) we're second out of 16 operators, number 2 out of 16. And in Australia I think you (indistinct) the opposite view there. There is an increasing wealth of evidence that shows that fees are the single (indistinct) determinant of long-term returns in both (indistinct). If I could just give a slightly different perspective. Simplicity has volunteered actually fund managers from – that represented 60 per cent (indistinct) so the lion's share of the market. We collectively made a decision about the asset management style that would most be fair for our members. So with not-for-profit, you get no motive other than increasing members' wealth. So we could have invested it any way we wanted it; hedge funds, asset management. We unanimously chose the lowest cost, asset management, as being the style that would return the most money to our members. We were not at all influenced or swayed by how much money we would make personally because (indistinct).

In that sense, as a fund manager, we're perhaps operating from a slightly more objective (indistinct) significantly more objective (indistinct) in terms of our motivation, which is very clear. That's what we read into those. The other advantage of that is that it removes the argument, which is prevalent here in New Zealand too, that asset management costs are a lot more than justifies the terms. It just doesn't. The cost of the fund managers and the fund management process relatively (indistinct) in terms of costs. My previous job I was managing $5 billion (indistinct) with my previous employer. They're a relatively serious argument but it is one that is used and has some credence, particularly (indistinct) to justify the two structures.

MR HARRIS: We might find a way of quoting you on that, I think.

MR STUBBS: I'm trying to be polite here, but my answer to that (indistinct) it's just not true. But it is a very good way of justifying fee structures. (Indistinct) some sympathy for that in Australia (indistinct) much more complex. I don't know whether you allow a hundred per cent online signing up for these things. But in this country that makes (indistinct) and significantly increases competition or it can significantly increase the potential for competition.

MS CHESTER: I've got two little questions. Member statements and member accounts, who sends them out to members and is it online?

MR STUBBS: Yes. It's a hundred per cent online and member statements and accounts are prepared by the administrator and then we stick our logo on it and (indistinct) and send it out to members. It is extremely more efficient.

MS CHESTER: Just following on from Peter's question about comparing your performance with others, for your own internal purposes, what's your sort of performance benchmark? What do you use to know whether or not you're doing the right thing by members?

MR STUBBS: I don't think you would have heard this from any other supplier before. What we do is we just take the market (indistinct) as distributed by Morning Star every year – sorry, every six months. That's our benchmark. So we benchmark ourselves against all 15 other providers. That's a publicly available report that becomes – we do our asset allocation twice a year based on those averages. (Indistinct) we don't have a competitive advantage in asset allocation. We're no smarter than anybody. But we would like all of those (indistinct) economists and bank economists would like to take advantage of their (indistinct) and we'll just (indistinct) as our benchmark.

MS CHESTER: Thanks very much, Sam. Thanks again for meeting with us. Also, the team was very impressed with your low-cost DNA such that you weren't going to fly across the Tasman, we had to do this over the phone. So we can see you're definitely not-for-profit.

MR STUBBS: Yes, indeed.

MS CHESTER: Thanks, Sam.

MR HARRIS: Thank you very much.

MS CHESTER: Have a good day.

MR STUBBS: Thank you. Cheers, bye-bye.

MR HARRIS: We have one last, which is COSBOA, I think, when we get Peter Strong on the phone. Peter, are you there, Peter Harris? Good afternoon. We're running late, sorry, mate. I've got Karen Chester here with me and a vast array, a roomful of people waiting to hear pearls of wisdom from you on the topic of default superannuation.

MR STRONG: I bet you they know what I'm going to say.

MR HARRIS: Well, I'm going to give you the chance to open up. I'll put you on the record myself. This is Peter Strong from the Council of Small Businesses of Australia on the phone. You're going to tell us a little bit about your opinion on default super. If you do get to it, Peter, and when you get a chance, particularly I think the potential for administrative support and supporting small businesses out of the ATO and SuperStream, we're particularly interested if you've got a view on that, but otherwise happy to take your comments over the phone now.

MR STRONG: The default fund issue from a business point of view means that a business is dealing with an entity and it hasn't chosen to deal with that entity. So the entity in a lot of the super funds do struggle to keep their records. We don't have a choice. We have to deal with the – whether it's efficient or not, whether it provides a good service, whether it's a good business to deal with, we have no choice in that supply. To us, it's provided by – is chosen by somebody else. So it sort of fails a business test in that we should have – if we're going to have to use superannuation we should have a lot more say in who to use or perhaps the super funds themselves can be graded on their ability to provide a service to the employer as well as to their members. Then if they don't supply good service they should never be considered to be a default fund if we continue with default funds, because it's not just our members we're looking after, it's the people that supply the money for them and in most (indistinct) small businesses when you look at the numbers.

The best way to resolve that, of course, is to make the default fund (indistinct) if there needs to be one, make that decision come from the Tax Office, although under what we're proposing there would be no need for that. If the Tax Office (indistinct) included in the tax collection, then the first time a fund is chosen by someone is the first time they (indistinct) a tax return to the Tax Office, which is normally after your first job. That's when they choose a fund because the Tax Office will ask them to select a fund. I think that process is much simpler, takes away the need for a default fund, takes it out of the workplace relations system and puts it into the tax system where it probably belongs.

I know the report came out yesterday on the superannuation and it was from the Senate Committee (indistinct). But certainly a lot of these inquiries wouldn't happen, the Senate Committee inquiry wouldn't have happened. This phone call wouldn't be happening if we were taken out of the collection process. It would be an issue between the funds and the people that owned the funds. Any questions on the way that should work? As I said, going back to the first choice is when I employed people I couldn't believe that I had to work with some of the industry funds – some of the super funds, not just industry funds – some of the super funds. They were just appalling at their data collecting. Their communication was appalling, was hopeless and they used to lose information all the time. As a business, I wouldn't work with someone that does that, but I had no choice.

MR HARRIS: This has been a theme of yours for some time, as I recall. I don't know whether in reading our draft report you might have noticed at one point we did mention the possible role of the future funds as a sort of a last-resort entity to do investing. Did you have a view on who should be the investing subsequently or are you reasonably agnostic about that?

MR STRONG: Reasonably agnostic. I mean, that's up to the funds to provide a choice. Our proposal increases competition, of course, because there's no default. You pick a fund based upon its performance, and not just on its performance but on the products it presents. Younger people may go more for the ethical funds. Older people may go more for funds where they've got more say in where the investments are put. So that market would then respond to the needs of the consumer and that's how it would work. The future fund, that's one option. Our proposal means there will be competition but beyond that, we're agnostic. That's up to the individuals who own the funds to work out what they do with it. Our concern is the collection process that puts an onerous demand on employers that I don't think should be there.

MS CHESTER: Peter, I've been the CO of a small medium sized business as well. I guess while it is the employee's money, as an employer, I would want my employee to be getting best bang for buck out of that salary because it's a cost to me. It's part of our wages but it's mandated as savings. So I would have thought employers would want to make sure that the employees – and here we're talking about default – is being defaulted into the best fund, the best-performing fund. Your view is that - - -

MR STRONG: I agree with you. As someone that employed people they would often ask me what was a good fund. I told them straightaway I'm not qualified to tell someone what's a good fund or not. I think we're putting a demand on employers that, to a degree, is illegal. You're not allowed to give advice on financial products, and neither should we. The advice I gave my people, I said, "Go and look up which one is performing best and which one" – because a lot of my staff were into the ethics of it all and I said, "Look up the ones that have the best ethics." Australian Ethical Investments was one that I always pointed to, but again, that was – I don't think it was allowed to be a default fund for some reason. It's none of our business per se to be giving them advice.

What we, I think, as employers we've got to do is make sure that they get the right wages, that they have a safe workplace and that they have a secure job. Beyond that, yes, we can get involved in other things such as – that's up to each employer. But I think the less we have to do beyond those (indistinct) then that means the employee can concentrate on what they need to do. I always did struggle with the fact that a default fund may be chosen by an employer when in actual fact they're not qualified financial advisors.

I note that some of the enterprise agreement that the default fund is chosen by the enterprise agreement, by the employer and (indistinct) involved. I've always scratched my head a bit about that as well. What are their qualifications to select a default fund? If that fund was to go bankrupt or something, who would be responsible for it? I understand the law removes that responsibility from the employer. That's what I've been told. But, again, that should be none of our business. That's the business of the person who owns the money and who's going to retire with it.

The other argument I've heard quite often is that workers perform better and they're more productive when the employer looks after them. Every study I've seen that says that is about big business. I've never ever seen a study that says if a small business owner worked another two hours on the weekend that everybody's happy and productivity increases because it's just not true. Putting extra demands on an individual to either pay someone to do the work or to do it themselves is what is not going to increase productivity.

MR HARRIS: In your experience of dealing with the ATO, now we've got a SuperStream operation up, so payroll providers are all linked in and that kind of thing, will that – I mean, I'm going to assume it's going to simplify your proposal. But do you – you see this, effectively, that superannuation becomes part of taxation remit now – taxation remit in terms of timing is a little different from the current timing of superannuation payments, if I recall rightly. I mean, super, I think, is paid quarterly. Is that at all an issue, do you think, from a business perspective?

MR STRONG: I've gone to members and talked to them about this because basically we could lodge our PAYG quarterly, if we wish, and we can lodge the superannuation quarterly. The temptation becomes not to lodge it; that's the problem. There's no excuse for that, by the way; you should lodge it. There's no excuse, but that's the problem, you get that choice. Now, under our proposal you wouldn't have (indistinct) it's all in one sum of PAYG which means once a quarter you pay (indistinct) if that's the way you want to do it. I went to my members and said, "Anybody concerned about that impact upon cash flow management?" I've got to say all of them said, "Look, we've got to remove that temptation to use superannuation as cash flow management," because I think, as you said before, it's someone's pay, it's not our money.

We know that employees steal from the workplace. Well, the best way of fixing that is remove the temptation. That's the same thing here is people aren't putting their super in, well, just remove the temptation, stick it in PAYG. The Tax Office, of course, that's part of their DNA to chase tax and to chase PAYG. They're higher on the list if a company goes belly-up. They get access to the money so the super is better protected. As I say, a couple of people said, "But, gee, that might make it more difficult with cash flow management." But even those people, when I discussed it with them, they said, "You're right. We've got to remove the temptation to use it for that purpose." We've got still got it for three months because cash flow management is (indistinct). You've got (indistinct) you've got something in others. So we've got it there to use for cash flow management for three months. So it's still (indistinct), it's just it's one lump sum instead of two or three or four.

MR HARRIS: That sounds pretty reasonable to me. That was the extent of the questions we wanted to get on the record for you. Have we got anything else before we sign off?

MR STRONG: No. We'll keep pushing but these things are going to happen. Can I say also I've just got to say that the Tax Office clearing house (indistinct) it is better. It is a lot better than having to deal with individual funds. In talking to bookkeepers and different people out there, the problem is still the industry – the super funds still contact the employer. They still send letters threatening legal action when there's no money owed. They still send us so much paperwork it's just ridiculous. So the payment process is certainly easier, but the paperwork is still coming in through the door and through emails, et cetera, and threats are still coming from the funds. Take the employer out of the situation and there won't be any need for threats to be made. Thank you for your time.

MR HARRIS: I appreciate that, Peter, thank you for your time.

MS CHESTER: Thanks, Peter.

MR STRONG: Thank you.

MR HARRIS: I think we're now at the end point where anybody who's remained dedicatedly throughout this and wishes to make any comment at all now gets the opportunity to make a comment. Have I got any comments from the floor that anybody wants to make? If not, then I think we're adjourned till Sydney next week. Thank you very much.

MATTER ADJOURNED AT 1.09 PM UNTIL MONDAY, 8 MAY 2017